2019 ECONOMIC AND INDUSTRY OUTLOOK

MAPFRE Economic Research

2019 economic and industry outlook

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Presentation

The world economy appears to be running out of steam in its cycle, slowing down to reach a growth rate of around 3.6% in 2018. The forecast for 2019 is that there will be a global economic slowdown, with growth of around 3.3%. These are some of the conclusions of the new edition of the *Economic and Industry Outlook* study prepared by MAPFRE Economic Research and published by Fundación MAPFRE.

The study is divided into two main sections. The first of these describes the outlook for the global economy and for a group of selected economies, while the second performs an analysis of how the economic environment might affect insurance demand, including a description of the main regulatory trends. Both sections contain forecasts for 2019 and 2020, adding information about the baseline and risk scenarios in the macroeconomic forecasts. As a new feature, regular readers of this publication will see that there has been an increase in the number of markets for which Non-Life insurance growth forecasts are offered. This information is now provided for 12 countries, in addition to the eurozone.

The *Economic and Industry Outlook* report is published annually in Spanish and English, and is updated every quarter to incorporate the changes arising in the world economy and the way in which these impact the insurance industry. With the publication of this report, Fundación MAPFRE maintains its commitment to the dissemination of economic and insurance knowledge, with the aim of helping to improve citizens' understanding of these matters and providing a supplementary working tool for those who need this type of information for their decision-making.

Fundación MAPFRE

Introduction

MAPFRE Economic Research presents its *Economic and Industry Outlook* report for 2019. As in every year, the aim of this report is to offer a global view of the outlook and forecasts for economic performance both worldwide and in the main economies, and to use this framework to analyze the environment that the insurance industry is likely to encounter.

This year, the report emphasizes that the world economy appears to be running out of steam in its cycle and is beginning to show signs of a clear slowdown. It is notable that the economy of the United States is playing a leading role in this process through its role in the tariff tensions with China, the imminent end of the effects of the tax breaks activated by the Trump administration, and the effect of the Federal Reserve's monetary normalization. Thus, the global economic slowdown will have three features: it will be increasingly asynchronous and fragile; it will be less intense in terms of activity and inflation; and it will take place in less favorable and divergent financial conditions. However, given the absence of any serious misalignments in the actors' balance sheets, the change of cycle slowdown is expected to be essentially orderly, and not a global recession crisis for the moment.

The current economic context will continue to favor the insurance market, but the slowdown of the main economies and the forecasted turning of the economic cycle could start to impact premium growth in the insurance market, especially the Non-Life and Life risk segment, given how closely its behavior mirrors that of the economic cycle. Apart from some specific cases, the continuing dynamism of economic activity in the emerging markets will result in greater growth for their insurance industries, supported by the still low rate of penetration of insurance in those markets, which translates into increased elasticity for premium increases as their economies grow.

We trust that this report will continue to contribute to the understanding of general economic performance and therefore of the environment that the insurance industry will face this year.

MAPFRE Economic Research

Executive Summary

Economic outlook

The world economy appears to be running out of steam in its cycle, slowing down to reach a growth rate of around 3.6% in 2018. It is notable that the economy of the United States is playing a leading role in this process through its role in the tariff tensions with China, the imminent end of the effects of the tax breaks activated by the Trump administration, and the effect of the Federal Reserve's monetary normalization.

The forecast for 2019 is that there will be a global economic slowdown with three features: (i) asynchronous and fragile growth; (ii) less intensity in terms of activity and inflation; and (iii) less favorable and divergent financial conditions. Given the absence of any serious misalignments in the actors' balance sheets, the change of cycle slowdown will be essentially orderly, and not yet a global recession crisis.

As regards the levels of economic activity, global growth of around 3.3% is expected in 2019, putting the output gap at around 0.3%. The developed markets will grow by slightly less than 2%, supported by domestic demand, which in part will replace exports, thanks to the increase in real income, the tight labor market, the still lax financial conditions and a broad real and financial wealth effect, which support consumption. All of this will be against a backdrop of low private leverage in general in the developed countries.

The emerging markets analyzed in this report, for their part, will see growth of around 5%, supported by global financial conditions that could be less unfavorable when their currency depreciation eases and there is an end to the upward support for interest rates in response to the Federal Reserve's monetary normalization.

Special mention should be made of the heterogeneous character of the global cyclical momentum present both in the developed and in the emerging markets, with the feature that both zones have reached the current situation through pro-cyclical policies that, if not administered correctly, could end up causing a global recession, although this is not the baseline scenario of this report.

Global inflation also has a strongly heterogeneous character. While the United States has virtually achieved its implicit inflation objective, core inflation in the eurozone and Japan remains very weak, suggesting possible signs of a new phase of downturn in economic activity. Moreover, general inflation is determined largely by the correction of crude prices, which, far from being good news, is partly a reflection of the global slowdown.

Global monetary policy, meanwhile, is delineated by the neutrality of the Federal Reserve, the laxity of the European Central Bank (ECB) and the Bank of Japan, and the recent hardening of the monetary stance of the emerging countries, aligned de facto with the financial system of the United States. Looking ahead to 2019, given the cyclical momentum and the current inflation expectations, it is expected that interest rates in the United States will not exceed the natural/neutral rate, which we estimate at 3%. The ECB, for its part, will continue to maintain a lax stance due to the deterioration of activity and core inflation. Last December, the ECB announced the end of the asset purchase program, maintaining for the moment the reinvestment of the principal, but held the benchmark rate at 0%, while simultaneously attempting to anticipate the perception that might be produced by deferring the increase in the benchmark rate. The divergences in the monetary policy of the United States and the other developed markets will result in the maintenance of a relatively appreciated dollar, especially against the euro and the yen.

Meanwhile, China's central bank temporarily relaxed its monetary policy in 2018, but can be expected to restore normality during 2019.

The current economic situation could represent an opportunity to reverse the pro-cyclicality that has prevailed in recent years. The US economy has grown, driven by a reduction in its structural balance in a context of monetary laxity, and this has resulted in a series of domestic imbalances that have had repercussions both in the United States and in third countries, especially in the emerging markets through the portfolio flows channel. The abrupt reversal of this pro-cyclicality of economic policy could transform our central scenario into a risk scenario, but this must be considered unlikely since the indicators that announce the change of cycle do not point toward a global recession.

Insurance markets

The current economic context is characterized by a loss of synchrony both in terms of economic growth and in the monetary and fiscal policies of the different regions at global level. At the moment, growth favors the insurance market, but the slowdown of the main economies and the forecast turning of the economic cycle may start to impact premium growth in the insurance market, especially the Non-Life and Life risk business, given how closely its behavior mirrors that of the economic cycle. Some emerging markets have suffered financial tensions as a result of past increases, more aggressive than expected, of benchmark interest rates in the United States, as well as due to their own imbalances, although it appears that they are managing to stabilize their economies. Apart from some specific cases, the dynamism that will sustain economic activity in the emerging markets will result in greater growth for their insurance markets, aided by the still low rate of penetration of insurance in those markets, which translates into increased elasticity in premium growth as their gross domestic product increases. Meanwhile, the rises in interest rates that are occurring in some economies will entail an additional boost for the Life savings and Whole Life annuity business of those countries.

In the eurozone, the economic context remains favorable for the development of the Non-Life and Life risk lines of business of the insurance industry, although the forecast economic slowdown will eventually affect the growth of those lines of business. Spain, for its part, will continue leading the growth among the major economies of the eurozone, although at a slower clip than previously. The ECB is following the forecasted monetary policy path, and no increase in interest rates is expected before the third quarter of 2019. This sustained context of low interest rates continues to be prejudicial to the development of traditional Life savings and Whole Life annuity insurance.

With respect to the major regulatory trends, after considering the request for postponement of the date of entry into force of International Financial Reporting Standard 17 on Insurance Contracts (IFRS 17), the International Accounting Standards Board (IASB) decided to grant a postponement of one year for the application of that accounting standard, so that it would apply to the preparation of the 2022 consolidated accounts of the listed insurance groups.

As regards supervision measures, a significant event was the publication in December 2018 by the European Insurance and Occupational Pensions Authority (EIOPA) of the result of the stress tests on the major European insurance groups that it performs every two years. The impact in two of the simulated adverse scenarios is significant, but at aggregate level the European insurance industry has sufficient own funds to absorb that impact. EIOPA stated that it will address the vulnerabilities highlighted in certain insurance groups through the supervision process, in the supervisory colleges of their respective groups.

1. Economic outlook

1.1 World economic outlook

The economic cycle runs out of steam

After reaching its cyclical peak in the second quarter of 2018, the global economy has been gradually slowing down to reach a GDP growth rate of around 3.6% for the whole of 2018, in line with the global trend of economic activity. Against this background, the emerging economies grew this year by approximately 4.7%, while the figure for the developed markets was around 2.2%.

The economic growth figure for 2018 clearly marks the beginning of the path of gradual and orderly slowdown that we had been anticipating since the end of 2017. Current global growth stands at 0.2% below the peak reached during the last five years, so it can be said that the world economy is entering into a new cycle.

Thus, cyclical slowdown appears to be a fact. The evolution of the Purchasing Managers' Indices (PMIs) at global level, the loss of dynamism in the growth rate for manufacturing orders, the gradual stock market correction seen since the middle of the year, the fall in corporate profits and, very especially, the global correction of trade flows and foreign direct investment (FDI) attest to this. All of these are symptoms of the change that is already palpable in trade, in investment and in global expectations (see Charts 1.1-a, 1.1-b, 1.1-c, 1.1-d, and 1.1-e).

United States: the leading actor

At global level, while in the case of trade activity the correction is due, in part, to the prevailing trade rhetoric between the USA and China, in the case of the correction of FDI (-41% in 2018) it reflects, above all, the fall-off in activity headlined by the USA, where companies repatriated profits from their subsidiaries in anticipation of the ending of the tax breaks activated by the Trump administration[1]. These advantages and their effects are gradually expiring, without offering any prospect of being renewed, given the restrictions arising from the country's public debt[2], with the consequent impact on domestic activity.

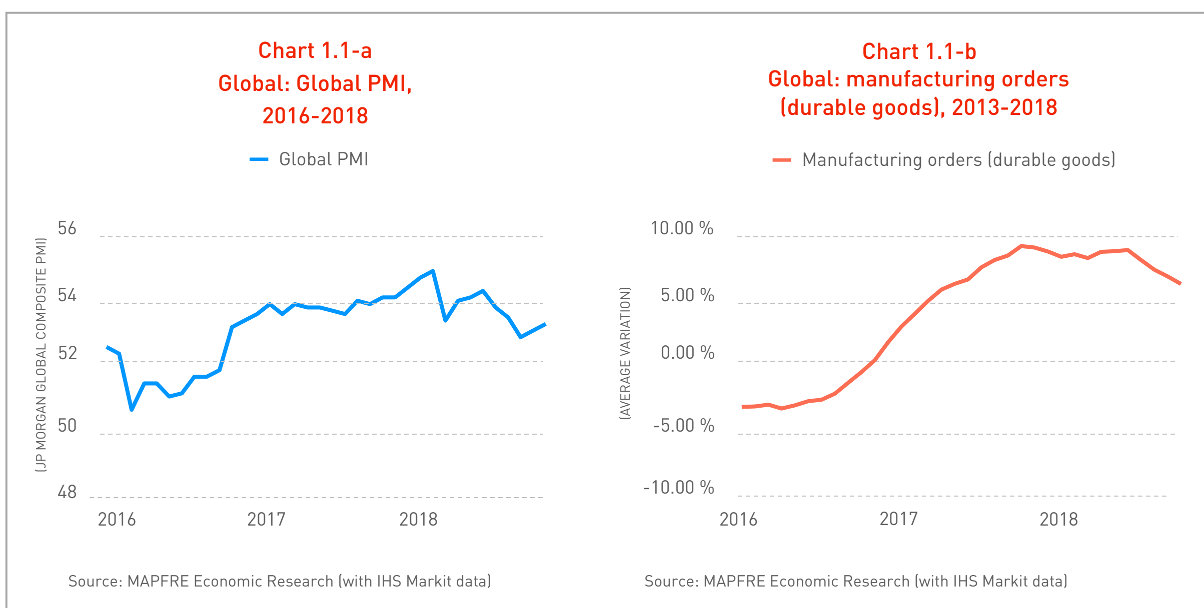


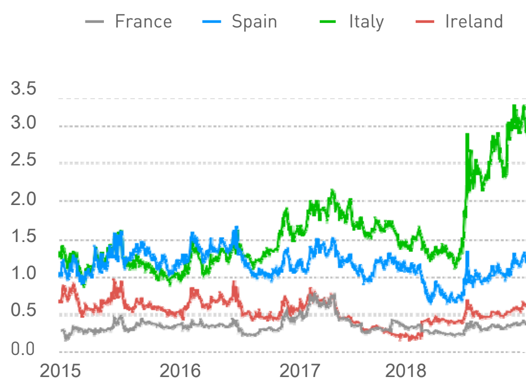
Chart 1.1-a
Global: Global PMI, 2016-2018

Source: MAPFRE Economic Research (with IHS Markit data)

Chart 1.1-b
Global: manufacturing orders (durable goods), 2013-2018

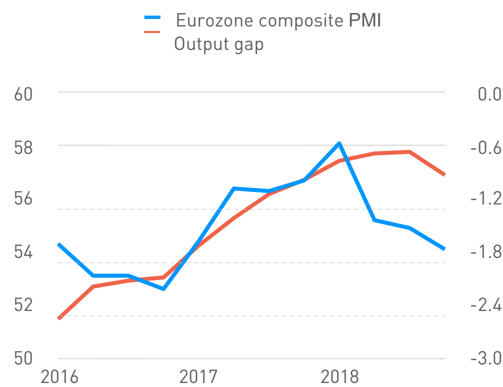
Source: MAPFRE Economic Research (with IHS Markit data)

Chart 1.1-c
Selected economies: risk premium, 2015-2018



Source: MAPFRE Economic Research (based on ECB data)

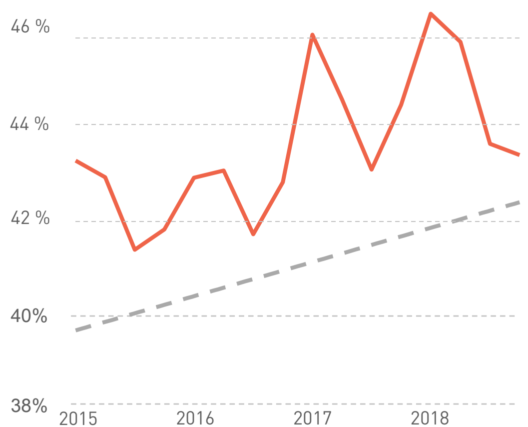
Chart 1.1-d
Eurozone: European PMI vs economic cycle, 2016-2018



Source: MAPFRE Economic Research (based on IHS Markit and Eurostat data)

At the same time, the United States is encouraging even more the repatriation of portfolio investment flows in the light of the normalization of the Federal Reserve's balance sheet and the increase in long-term interest rates (the 10-year rate is at its highest since 2008), and this affects financial conditions, the exchange rate and the activity of emerging countries that are highly integrated with the US financial system due to interest rates and/or exchange rates, with impacts on their level of indebtedness in dollars and on their current account (all the more so in a context of lower revenues from commodities).

Chart 1.1-e
Europe: intra-European trade (total EU28 imports and exports vs EU28 GDP) as % of GDP, 2015-2018



Source: MAPFRE Economic Research (based on Eurostat and European Commission data)

At the same time, the trade standoff between the United States and the rest of the world is already showing its first effects on global trade, especially via the expectations channel, which affects investment and exchange rates. The temporary truce[3] agreed between the United States and China during the G20 summit in Argentina eased the situation slightly but did not eliminate the problem.

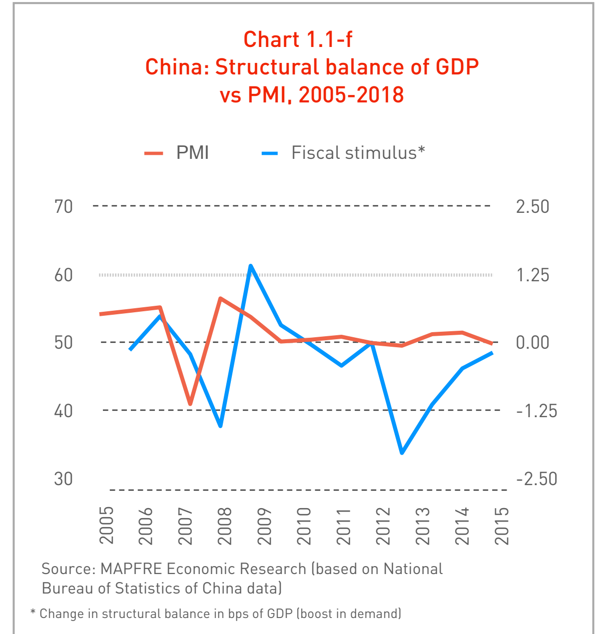
In this slowdown, attention is focused on the advanced cyclical momentum of the economy of the United States, which is also entering into the largest expansion (albeit less intense) in its history. Thus, as we anticipated in our last year's report, the United States is currently the leading actor in the change of cycle in both our baseline scenario and our risk scenario.

Looking ahead

Looking ahead, it can be predicted that 2019 will be characterized by a global economic slowdown with three features: (i) asynchronous and fragile growth; (ii) less intensity in terms of activity and inflation; and (iii) less favorable and divergent financial conditions.

In the baseline scenario of this report, it is anticipated that this slowdown will be smooth and orderly, since for the moment there are no signs of substantial misalignments in the actors' balance sheets[4] that might trigger an adjustment of systemic dimensions for global activity and nominal variables. That said, the latent risks that were flagged up a year ago not only remain, but in some cases have become more likely (see Chart 1.1-g). This is especially true of those relating to global economic governance and foreign policy, with a leading (but not exclusive) role for the United States. These risks take on greater significance given the nature and location of some regional imbalances[5] that are all the direct or indirect product of a clearly pro-cyclical global economic policy (see Box 1.1-a).

Chart 1.1-f
China: Structural balance of GDP vs PMI, 2005-2018



Source: MAPFRE Economic Research (based on National Bureau of Statistics of China data)

* Change in structural balance in bps of GDP (boost in demand)

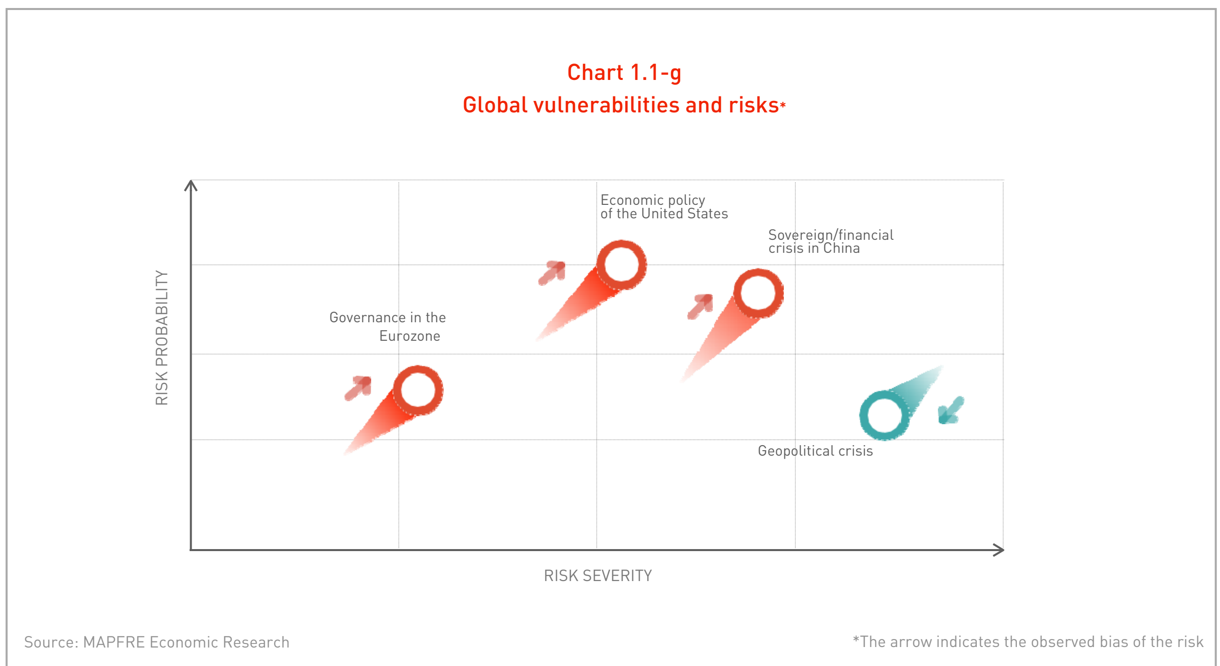
Economic activity

The global growth rate forecast to 2019 is approximately 3.3%, which clearly places the global output gap at around -0.3%. The contribution to growth by the developed and emerging markets will be similar, but with an improving trend for the emerging markets compared with the previous year and a worsening trend for the developed markets.

The developed markets will see growth below 2% supported by domestic demand which in part will replace exports, the overseas sector, thanks to the increase in real income, the tight labor market, the still lax financial conditions and a broad real and financial wealth effect, which support consumption. All of this will be against a backdrop of low private leverage in general in the developed countries.

The emerging markets[6], for their part, will see growth in the region of just below 5%, supported by global financial conditions that could be less unfavorable when their 2018 currency depreciation eases

Chart 1.1-g
Global vulnerabilities and risks*



Source: MAPFRE Economic Research

*The arrow indicates the observed bias of the risk

Box 1.1-a
Coordination of monetary and fiscal policies and their effect on the economic cycle

Monetary and fiscal policies and economic cycle

The most recent macroeconomic data appears to indicate exhaustion of the economic momentum once its trend level has been achieved. However, this slowdown in the pace of activity does not imply its exhaustion in terms of contraction, but rather a tempering of growth rates. This scenario is the result of sources of risk such as trade frictions, adjustments in emerging markets, high debt ratios and geopolitical tensions that have been passed on to the financial markets in the form of corrections and volatility. Thus, the tipping point in the global growth that was previously being observed in a generalized manner (deferred in the case of the US economy by the tax reform) might be considered to be "taken for granted" at the close of 2018.

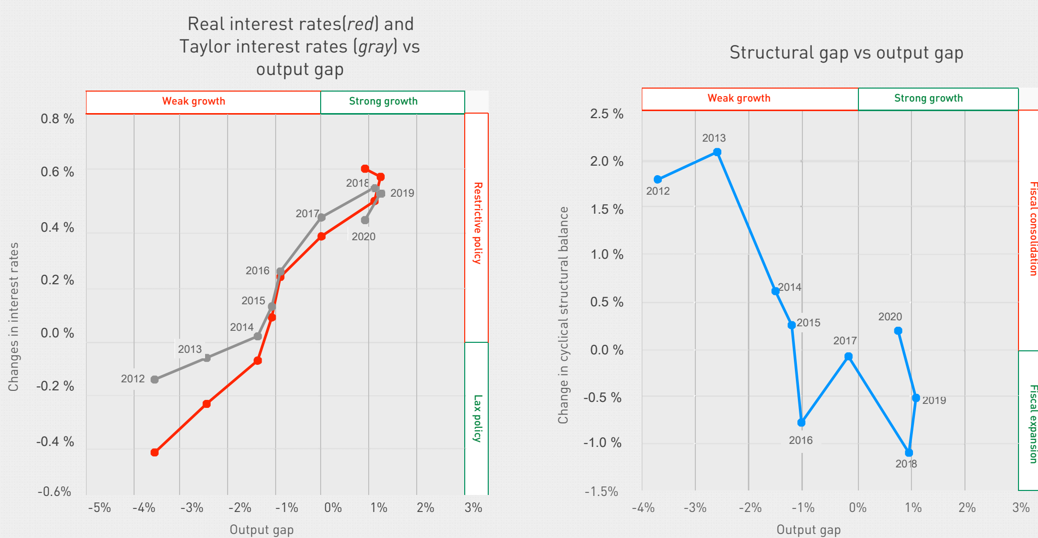
In this regard, and with a view to 2019, to understand the current divergence it is necessary to observe the evolution of the different economies, as well as the discrepancies in terms of the coordination between monetary and fiscal policies.

United States

In 2012 the US economy started out from a negative output gap that was eliminated through ultra-lax monetary policies (via reductions in interest rates and balance increases) as suggested by the theory on counter-cyclical policies.

In fiscal terms, the policies were mildly restrictive, with a structural balance tighter than the trend, which is inconsistent with the economic theory. As the output gap diminished, the monetary policy was adjusted from its initial stance of laxity toward a neutral dimension. However, the Trump administration's tax reform, as well as a degree of tardiness on the path of normalization of monetary policy marked out by the Taylor rule, has meant that what was originally perceived as a stabilizing tone of the economic policies is assuming a certain pro-cyclical character, acting as an amplifier of the impetus of the economic cycle (see Chart A).

Chart A
United States: real interest rate, Taylor interest rate and structural balance vs output gap*



Source: MAPFRE Economic Research

* Variables expressed as differences

Box 1.1-a (continued)
Coordination of monetary and fiscal policies and their effect on the economic cycle

Eurozone

The idiosyncrasies of the eurozone make a study of the overall fiscal policy especially complex. The economic union is far from being regarded as a supranational entity with policymaking power, so the member countries retain their sovereignty in fiscal and public spending matters. Although a combined study of the data conceals divergences in the fiscal policy implemented by each member country, a series of common patterns can be inferred. In 2012, the eurozone started out from a structural balance that was strongly negative and below its trend level (counter-cyclical expansionary fiscal policies). This coincided with an output gap of around -3.5%, and was reversed in subsequent years through the implementation of "austerity measures" with restraints on spending and an increase in revenue-raising capacity. However, despite the gradual approach toward trend growth levels, the fiscal policies continue to maintain a counter-cyclical tone. As regards monetary policy, Chart B clearly shows that the monetary decisions of the European Central Bank appear to be excessively conservative. The ideal nominal interest rate, as marked out by the Taylor rule, indicates that the interest rate should have been reduced more sharply during periods of economic stagnation. Conversely, at a time when gross domestic product is clearly heading toward its trend level, greater vigor in the normalization of monetary policy appears necessary.

Emerging markets (excl. China)

Historically, the macroprudential policies of the emerging markets have been pro-cyclical. This has contributed to exacerbating the effects of the economic cycle ("when it rains, it pours") and brought about an additional source of volatility (Carneiro & Garrido, 2015). In fiscal matters, the public finances of the emerging markets tend to be closely linked to the availability of financing. Thus, access to the capital markets is a necessary condition for the implementation of fiscal stimulus.

Chart B
Eurozone: real interest rate, Taylor interest rate and structural balance vs output gap*

Source: MAPFRE Economic Research

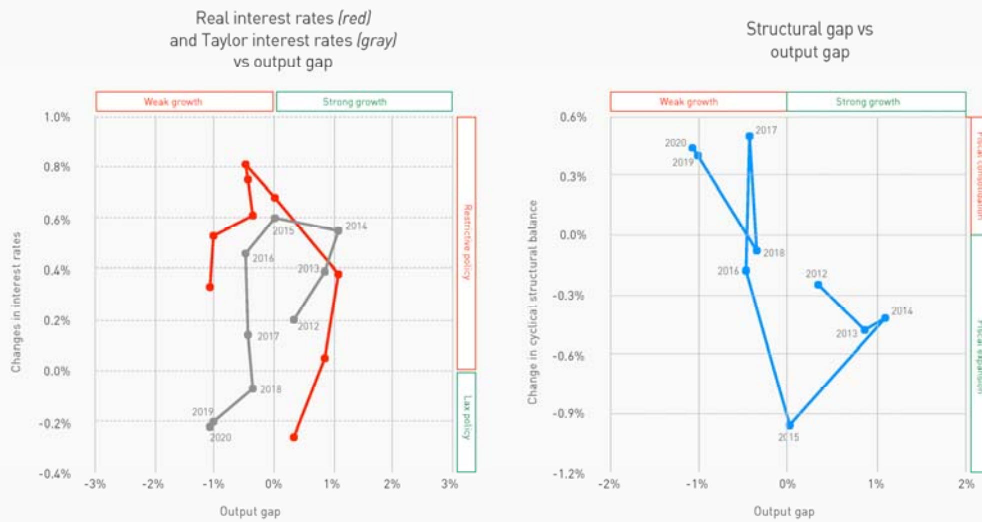
* Variables expressed as differences

Box 1.1-a (continued)
Coordination of monetary and fiscal policies and their effect on the economic cycle

Chart C.
Emerging markets (excl. China): real interest rate, Taylor interest rate and structural balance vs output gap*

Real interest rates *(red)* and Taylor interest rates *(gray)* vs output gap

Structural gap vs output gap



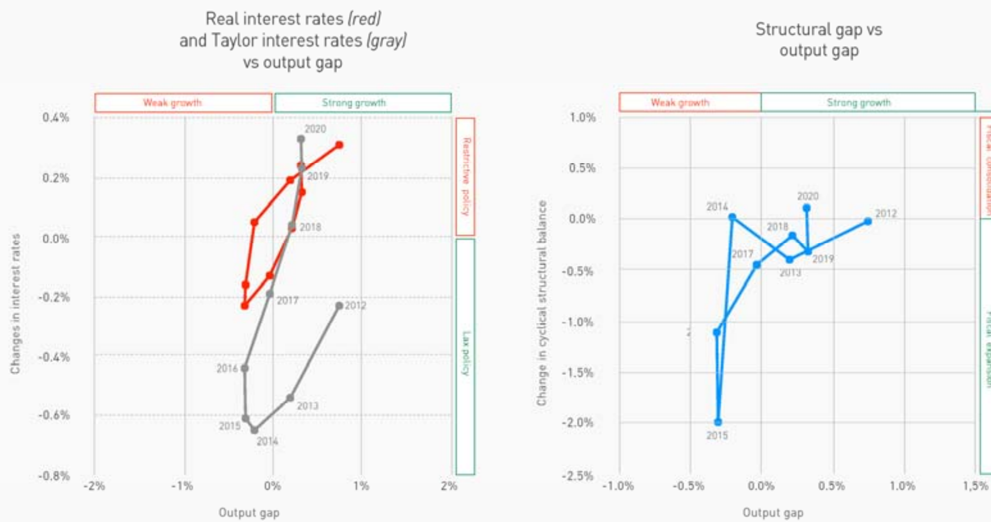
Source: MAPFRE Economic Research

* Variables expressed as differences

Chart D.
China: real interest rate, Taylor interest rate and structural balance vs output gap*

Real interest rates *(red)* and Taylor interest rates *(gray)* vs output gap

Structural gap vs output gap



Source: MAPFRE Economic Research

* Variables expressed as differences

Box 1.1-a (continued)
Coordination of monetary and fiscal policies and their effect on the economic cycle

In its turn, the ability to access the financial markets is highly determined by the perception of the country's fiscal solvency, which is weaker in times of recession. On the contrary, being an exporter of commodities increases the pro-cyclical character, due to the losses of tax revenues caused by fluctuations in their prices. In this regard, and despite the efforts made since the 2008 crisis to reverse this tendency, the fall in commodity prices against a backdrop of global slowdown, added to the resurgence of protectionist policies and the difficulties in accessing the capital markets, suggests that the emerging markets might be sinking into a pro-cyclical spiral that would be difficult to reverse (see Chart C).

On the monetary policy front, imbalances such as the level of indebtedness in foreign currency (mainly in dollars), the current account positions or the level of international reserves produce a certain dependency on the monetary conditions adopted by their creditors, primarily by the US Federal Reserve. Thus, the accumulation of vulnerabilities in an environment of persistence of the economic cycle would explain sharp adjustments such as those seen in Argentina and Turkey.

China

Throughout this decade, China's monetary policy has been characterized by relatively low interest rates, ranging between 2% and 4%. However, the changes in interest rates have been smaller than those recommended by the Taylor rule, and during the 2012-2015 period were in a direction opposite to that recommended (pro-cyclical). From 2015 onward, coinciding with the correction on the Shanghai stock exchange, the movement of interest rates begins to be consistent with the economic theory. This convergence toward counter-cyclicality is currently seen in the reduction of interest rates and in the slackening of reserves coefficients and collateral eligibility criteria, with the aim of softening or moderating the fall (see Chart D).

In fiscal matters, the mostly neutral tone coincides until the great expansion that took place in 2015. In subsequent years, the Chinese economy made efforts to correct imbalances and recover fiscal space. However, the latest measures announced in relation to increased spending and reduction of the business tax burden show the counter-cyclical character of the Chinese economy.

and there is an end to the upward support for interest rates in response to the Federal Reserve's monetary normalization that has resulted in perceived (negative) pro-cyclicality during 2018 (see Box 1.1-a). It should be remembered that currently 11 of the main emerging markets are maintaining their monetary policy in neutral restrictive/restrictive territory.

It is important to note that the block of developed markets is not homogeneous. The cyclical momentum of the United States, Germany and Spain (among others) is much more advanced that that of Italy and France, for example. Moreover, the eurozone as a whole and Japan – unlike the USA – still maintain a non-negligible negative output gap, which in the case of the eurozone could give rise to a renewed regional fiscal stimulus[7].

Among the emerging markets, meanwhile, the cyclical momentum is also heterogeneous, but looking ahead, there are three factors that will affect the block as a whole: (i) the reduced margin for tightening the financial conditions arising from the monetary normalization of the United States, (ii) a trajectory of the oil price that starts at levels lower than those predicted a year ago[8], and (iii) an increasingly modest

performance from China requiring the activation of new expansionary fiscal policies.

Prices

In the same way that the cyclical momentum is heterogeneous, so is global inflation. The United States has practically achieved its implicit (twofold) objective for activity and inflation. Its labor market, with virtually full employment, should ensure a greater acceleration of core inflation, especially against the backdrop of a trade war and more expensive imports. Conversely, in the eurozone and Japan, despite the initial upturn, core inflation remains anchored at around 1% or below (when the eurozone objective is 2%).

Beyond the underlying price dynamic, in 2019 inflation in general will be strongly influenced by the recent correction in crude prices. Brent recorded a fall of approximately 30 USD/b between the third and fourth quarters of 2018, a performance attributable to the producing countries' inability to adjust to a lower level of global demand at that time (although eventually OPEC decided to reduce production by 1.2 million barrels a day)[9]. Thus, the curbing of the price of oil is not good news, since 54 USD/b is partly a reflection of the global output gap. Regardless of this, these effects will be reflected in the general price indices over the first half of the year.

In summary, unequal economic activity and prices will give rise to unequal levels of nominal output growth as well, and also to visible differences in global monetary policy and divergences in global financial conditions.

Global monetary policy and financial conditions

The momentum of monetary policy in the developed markets continues to be led by the United States. However, in general, it is against a backdrop of neutrality of the Federal Reserve and laxity of the European Central Bank (ECB) and the Bank of Japan (see Box 1.1-b). Among the emerging markets we see the difference between the neutral tone of China's central bank (PBOC) and, in general terms, the restrictive monetary policy of the rest of the major emerging countries (at least 11 of them), which hardened their monetary stance by following the Federal Reserve but which now, going forward, are showing a less restrictive inclination.

The Federal Reserve raised interest rates again in December to 2.5%. It did this despite external pressures, thus confirming its independence and the fact that consistency of forward guidance is the main objective of its Chair, Jerome Powell. Similarly, however, it was made plain that it was necessary to maintain caution with the rate increases, especially in a context of high sensitivity of corporate leverage and foreseeable lower revenues given the current end phase of the economic cycle in that country. Moreover, this is taking place in the midst of a debate about the neutral/natural rate for the economy[10] that involves a discussion about whether this is closer to 3% or 3.5%. The first option (which constitutes the baseline scenario of this report and the one assumed by the market) allows less movement in interest rates within the neutral ground of monetary policy in 2019, while the second requires a supposition that the economy's output gap is greater than was believed[11]. Our opinion is that, given the cyclical momentum and the steady inflation expectations, interest rates in 2019 will not exceed the neutral rate (which we place at 3%[12]), and we therefore anticipate no more than two increases during the year (50 basis points in total).

Meanwhile, at its December meeting, the ECB announced the termination of the asset purchase program, maintaining, for the moment, only the reinvestment of the principal. It also gave signs that it is prepared to leave the benchmark rate untouched beyond the spring, opening up the possibility of a normalization of balance sheets and a rise in the deposit rate before any rise in the monetary policy rate. Thus, the ECB's stance is therefore still lax as regards its monetary policy, especially given the rapid deterioration of activity and core inflation in virtually the entire region.

Box 1.1-b
Exchange rate, monetary policy and economic cycle

European Central Bank

On December 13, the European Central Bank (ECB) announced that interest rates will remain unchanged (0% and -0.4%, respectively) at least until the second quarter of 2019. As regards the asset purchase program, the ECB is ending the net acquisition phase and starting to reinvest the principal in order to ensure liquidity, without ruling out the possible co-existence of this mechanism with that of changes in interest rates.

In macroeconomic terms, the ECB confirms the downward forecasts due to the increase in risks, both global and within the eurozone, once again downgrading the prospects for normalization of interest rates. Proof of this is provided by the slope in the interest rate curve that can be observed through the differentials between 2/5 and 2/10-year rates. The fact that interest rates break down into one long-term rate for term premium (inflation) and another short-term rate for expectations (monetary policy rates) makes it possible to interpret a certain fatigue in the perceived sentiment (see Chart A).

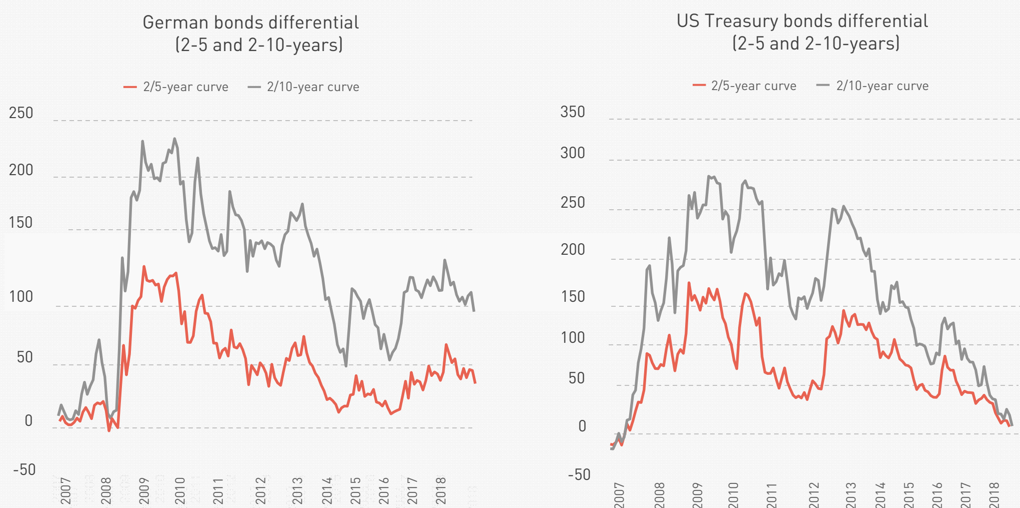
The deterioration of the cyclical position of the eurozone and the low "pain threshold" of the economies with limited fiscal margin as regards monetary normalization could push the prospects for an increase in the price of money beyond the spring of 2019.

The Federal Reserve

On December 19, the US central bank pushed interest rates back up into the 2.25-2.50% range, maintaining the pace of balance reduction at USD 50 billion per month.

The macroeconomic projections indicate a slowing of growth for the US economy, with a lowering of the projections for 2019 by 0.2% to 2.3%, and a fall in inflation expectations as indicated by the breakeven rate for US bonds in recent months. The softening of tone in the most recent interventions by the Chair of the Federal Reserve begins to be reflected both in the slope of the US rate curve (negative on the 2/5-year section and with few points on the 2/10-year section) and in the published "dot plots" (see Charts A and B), increasing

Chart A
Germany and United States: interest-rate curves for 2-5 and 2-10-year bonds, 2007-2018



Source: MAPFRE Economic Research (with Bloomberg data)

Box 1.1-b
Exchange rate, monetary policy and economic cycle

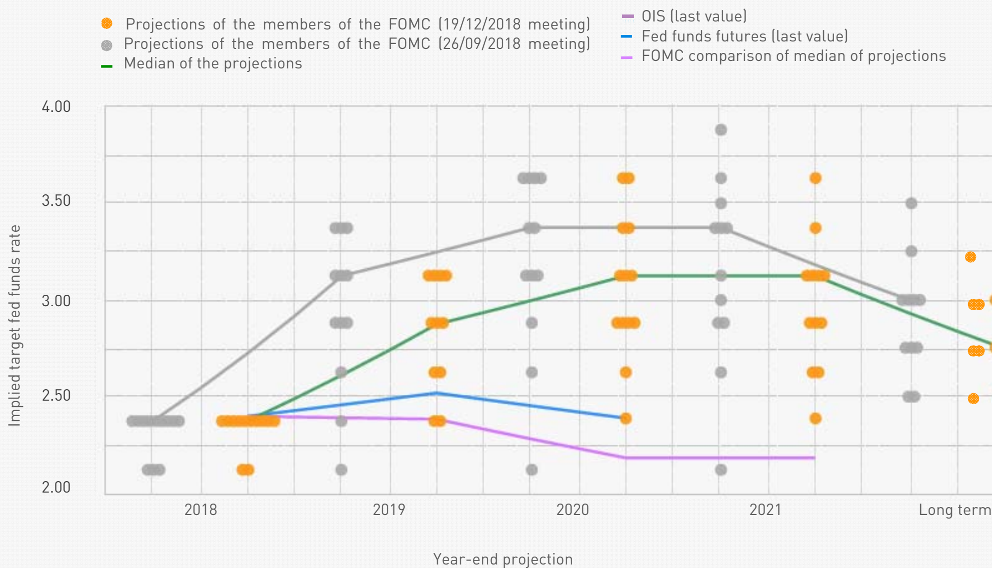
the likelihood of a pause in normalization in 2019 while awaiting a better measurement of the real cyclical momentum of the US economy once the effects of the tax reform have been diluted, when it reaches the anticipated level of 3%.

Prospects for 2019

The central banks face a critical year in 2019, in terms of the loss of economic vigor and being immersed in a process of monetary normalization where any wrong move could result in increased volatility in the markets.

In this regard, the US Federal Reserve will draw up a less restrictive monetary policy, in line with the economic slowdown. Meanwhile, its European counterpart, the ECB, will have to decide whether to take advantage of the opportunity that would be opened up to normalize interest rates and recover some monetary policy wiggle room in the light of the likely pause on the part of the Federal Reserve, or instead to defer normalization and move its monetary policy toward the "new normal" of low interest rates that characterizes the Central Bank of Japan.

Chart B
US Federal Reserve Dot Plot (12/19/2018)



Source: MAPFRE Economic Research (with Bloomberg data)

Moreover, given that the Federal Reserve is maintaining its asset sale program at 50 billion dollars a month and the ECB is only reinvesting the principal, one would expect – in the current environment of balance sheet normalization – that the net balance of the global flow of assets and liquidity will be negative in the second half of 2019, with two consequences. Firstly, additional upward pressures on the long sections of the interest rate curve, so that in aggregate terms the slope of the global rate curve (not only the American one) should lose the current flattening. Secondly, additional room for maneuver in global monetary policy,

for example if the United States decides to ease its asset sale program in order to stimulate investment without touching the benchmark interest rate. Thus, the neutral tone adopted by the Fed and the lax stance of the ECB will be a factor that will contribute to keeping the USD relatively buoyant against the euro (we expect an average exchange rate of around 1.18 at the end of 2019, while we estimate that the equilibrium exchange rate will be in the range of 1.20 – 1.25).

In the emerging markets however, the monetary policy spectrum is reversed. It ranges from the current neutrality/laxity of China's central bank to the monetary restriction of the central banks of Argentina, Turkey, Mexico and Indonesia, among others. China reduced the required reserve ratio for its financial system in December, impacting its interest rate, which approached 2% below its neutral rate, although this has already corrected itself back up to 3%. The central banks of the other emerging markets in general hardened their monetary policy in response to internal shocks (Turkey, Argentina, South Africa) or in response to the Federal Reserve's monetary policy during 2018. The stance for 2019 in both cases, however, seems to be the opposite. For China it is likely that it will return to interest rate levels similar to those at the start of 2018, particularly to accommodate the renewed fiscal stimulus, maintain financial stability and the necessary deleveraging. Whereas in the other main emerging markets (that finish their political cycles and could face fewer upward pressures from the Federal Reserve) no major interest rate increases are expected, although their anchoring conditions will remain relatively restrictive due to the exchange rate effect, the level of country risk and the still high domestic and US dollar interest rates.

An opportunity for reversing pro-cyclicality

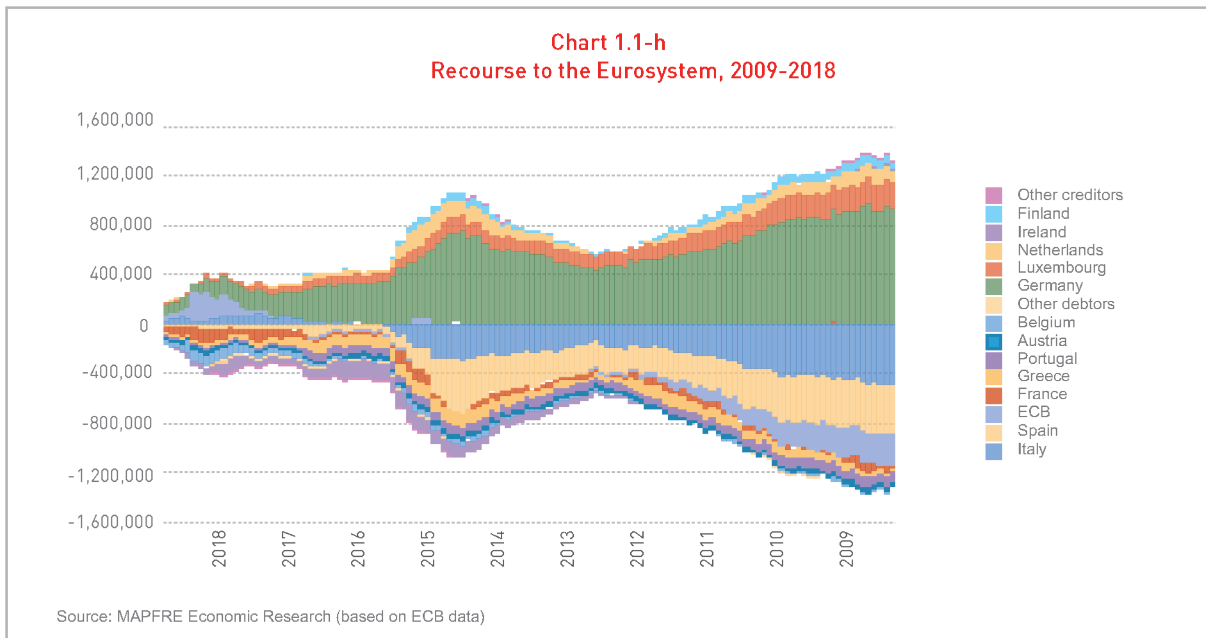
From Box 1.1-a relating to macroeconomic policies and their effect on the economic cycle, it can be concluded that the path to the present moment has been traveled largely in a context of strongly pro-cyclical policies and that these have been closely tied to the role played by the economic policy of the United States.

The growth of the US economy in recent years has been supported by strong fiscal stimulus driven by the Trump administration against a background of monetary laxity (although this is moving toward normalization) and a positive output gap, which has generated some domestic imbalances, especially in the public and corporate sector (debt). Moreover, this economic policy also impacted the smaller emerging markets because the rise in interest rates affected capital flows and prices, as well as the financial conditions of those markets when they most needed that support.

The economic policy of the United States was pro-cyclical at the peak of its growth, while the emerging countries were pro-cyclical in the recessive phase (after having been similarly pro-cyclical due to the same mechanisms in the expansive phase, when the United States' QE was active). Similarly, China has maintained an excessive fiscal and quasi-fiscal laxity throughout the last few years (through the financing of state-owned companies and through expenditure on infrastructure), at the same time as maintaining a relatively soft monetary stance in order to keep its currency depreciated (especially against the background of the tariff war and to absorb the potential increase in tariffs), giving rise to a similar generation of imbalances, particularly in the residential sector and in corporate leverage[13]. Thus, the result has been an accumulation of current imbalances[14] and the recent tightening of some of them, which could end up triggering a sharp nominal adjustment.

Looking ahead to 2019, the slowing of global economic growth could reverse this pattern by entailing a barrier to the hardening of monetary policy in the eurozone, which would continue to be accommodative in nature, giving greater weight to the use of counter-cyclical policies that soften the slowdown, so that its tendency would remain counter-cyclical for the moment. This is of particular importance in demonstrating the enormous dependency that exists via cross-financing between countries of the eurozone, by way of mutualizing support for growth (see Chart 1.1-h).

Chart 1.1-h
Recourse to the Eurosystem, 2009-2018



Source: MAPFRE Economic Research (based on ECB data)

In the case of the United States, the fiscal stimulus would not involve an expansion of the program, thereby putting a brake on its pro-cyclical nature, while as regards monetary policy we would observe a progressive softening of tone while waiting to see the economy's performance and the delayed effect that the rises in interest rates have on it. In this regard, the emerging markets with high dependency on the Federal Reserve would see their situation somewhat eased and would have to make fresh fiscal efforts to stabilize the cycle. Finally, China would reactivate the counter-cyclicality observed through the fiscal expansion initiated in 2018, but all the while safeguarding the existing monetary margin.

Slowdown or recession

In the current global economic outlook, the central unknown quantity would appear to be to discern whether we are facing a smooth and virtuous change of economic cycle that is capable of being managed with the current economic policy and will ultimately make it possible to correct the imbalances generated by the global (pro-cyclical) economic policy of the last five years without causing a new crisis, or whether instead we are facing the gestation of a new global crisis arising from those imbalances that might be detonated by some of the elements of the balance of risks that are set out in Chart 1.1-g.

In our opinion, the global economy is entering into a scenario of orderly adjustment that will serve to correct the imbalances of the past, and at present there do not appear to be any elements that make it possible to anticipate a global recession. This conclusion is the result of weighing the symptoms and risks and putting them in perspective, and of accepting that if a global recessive crisis were to break out, this could only be created in the United States, although it could be amplified and disseminated by the emerging vulnerabilities[15] and the weaknesses of other developed regions such as the eurozone. Some elements make it possible to go more deeply into this interpretation.

There are abundant cyclical signs that anticipate change, but they are not signs of crisis

- Reduction of the term premium in the interest rate curves of developed markets, especially in the United States (a natural indicator of slowdown, but not always of the imminence of a crisis, for which it would have to be reversed). Other long-term structural factors also have an influence, such as demographics and the secular slowing of growth. Proof of this can be found in the fact that the longer-term slope (30 years) is on the turn.

- Growth with full employment, which in part recovers a population that had ceased to be active, as well as slowing migration and female participation.

- High stock market valuation of the developed corporate sector, as measured by price to book value, currently 50% higher than the historical average (but also 15% below the peak reached in the middle of the year). The correction in the value of equity is currently orderly and in line with a regulated adjustment of expectations. Moreover, these excessive valuations are occurring in a scenario of liquidity drain, and therefore it cannot be assumed that they are bubbles.

The financial accounts and balance sheets of the actors face challenges

- This is especially true for the emerging corporate sector leveraged in strong currencies, which can be sensitive to a greater hardening of global financial conditions (unlikely at the current cyclical moment, as explained earlier, and in any event incapable of causing a global crisis, but certainly a transmitter of any possible shock).

- Part of the US corporate sector which, being highly sensitive to an increase in corporate spreads and deterioration of the price of sovereign assets (the yield on the US 10-year bond stands at 2.7%, the highest in a decade), could face solvency and funding problems in the medium term (in our opinion only in the face of a sharp upward adjustment of financial costs and global risk aversion, which is essentially the risk scenario of this report).

- Household balance sheets have improved after the deleveraging that followed the crisis and thanks to the revaluation of real and financial assets resulting from low interest rates and the upturn in expectations, as well as enjoying a return to income levels much higher than those of 10 years ago thanks to real growth in salaries (in the case of the United States).

- The indebtedness of the public sector in the developed world is very high. This is only a risk of recession when there is a feedback between sovereign risk and banking risk fundamentally, of the kind that produced the eurozone crisis in 2011. This is not currently the case in the United States, and within the eurozone it represents a problem only in Italy (see Chart 1.1-c). The process of bank resolution in that country is in full flow, and the pressure on the level of its sovereign risk has not been passed on to the periphery of the region (see Chart 1.1-c). In any event, the indebtedness of the public sector would make it difficult to exit from a possible recession due to the inability to implement counter-cyclical policies and due to crowding out and Ricardian effects on investment and consumption.

Exuberance in the price of some assets

- Exuberance in the price of some real assets (property) is selective in cities where there has been neither deleveraging nor a real estate adjustment. However, these are not events that are generalized at national level, much less throughout the developed world. In any event, the current environment of interest rates a long way from zero (in the United States and other regions, unlike previous phases) suggests that this is not, for the moment, a bubble liable to burst (except in China, where the government would likely take measures to prevent it).

Global economic governance faces disturbances

- Although the immediate focus as regards the dangers for global economic governance is centered on the trade war and its effects on economic activity through trade and investment, the short-term effects are difficult to quantify[16]. There is, however, a greater risk of institutions being pressured by a political or market agenda. The most significant case is the pressure the markets and the current US administration have attempted to apply

on the Federal Reserve (a monetary policy error by the Federal Reserve would be the trigger for our alternative risk scenario).

The risk scenario

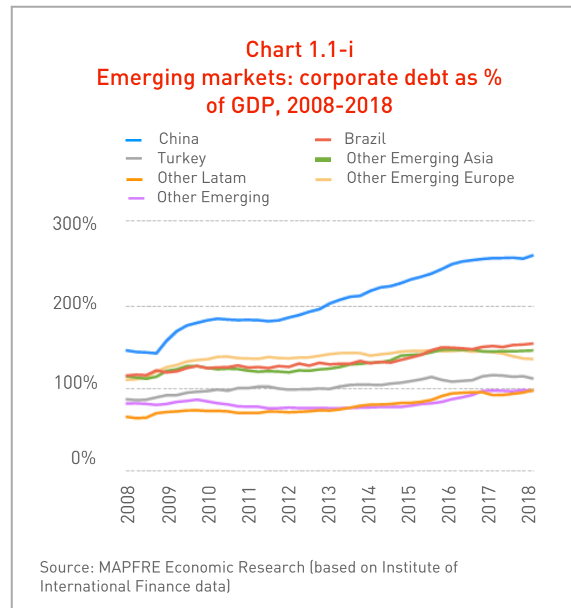
For the purposes of this report, the risk scenario is derived precisely from a context of global trade and geopolitical tension, even with an adjustment of imbalances that amplify and transmit the initial shock, which would originate in the United States. It essentially represents a materialization of the risks shown in Chart 1.1-g, fueled by an (induced) error of economic policy, in this case monetary policy.

As in the past, in this report we identify as our alternative scenario a situation of risk (not a marginal or improbable situation) with an effect on economic activity and prices, resulting in lower real and nominal growth of domestic demand and therefore a decline in the performance of the insurance industry. It is also a risk scenario because it would involve the depreciation of all currencies against the euro, so that the consolidation of the conduct of insurance activity would also be affected. Finally, this is a scenario that would involve loss of the term premium of the global interest rate curve (with reversal for some curves, such as the US curve, or flattening for others such as the German, due to a refuge effect), the effects of which would also be seen in the insurance business, particularly in the Life segment.

Thus, this scenario makes the following assumptions:

- A Federal Reserve that constantly raises interest rates until they reach 3.50-3.75% in the first quarter of 2020.
- A sharp increase in global risk aversion, reflected in the VIX volatility index, which would rise rapidly from the current level of 20 to 35 over the second half of 2019.
- A stock market fall of 10% coinciding with the moment of greatest volatility.

Chart 1.1-i
Emerging markets: corporate debt as % of GDP, 2008-2018



Source: MAPFRE Economic Research (based on Institute of International Finance data)

- An intentional depreciation of the Yuan as a response to the trade tensions, taking it to 8.0 USD/CNY in the short term.
- A more rapid recovery of oil prices than in the baseline scenario, with Brent reaching 85 USD/b in the first quarter of 2020 due to geopolitical problems affecting supply.
- A reduction in interest rates (on safe-haven assets in Europe and on the US Treasury bond, for different reasons).

The trigger for this scenario would be a poor monetary policy reaction from the Federal Reserve (and its resulting reaction from the market), amplified by the imbalances acquired during the pro-cyclical stage of the Federal Reserve (overvaluation of corporate bonds) and little room for maneuver in terms of economic policy. The shock considered in this scenario could reverberate through confidence channels and international investment flows, and could generate liquidity problems in the corporate sector in the United States (increased tension from corporate spreads) and solvency problems in the corporate world in the emerging markets (see Chart 1.1-i).

1.2 General forecast and risk assessment in selected economies

1.2.1 United States

Growth holds up but a change of cycle is approaching

The United States economic boom continues, with a growth rate of 3.5% QoQ in the third quarter that places the YoY rate so far at 3%, ratifying our estimate of a rise in GDP in the region of 2.9% for the whole of 2018, above the average growth rate for the last five years, and probably representing the peak of the current cycle.

The growth in activity relies exclusively on the good performance of domestic demand, propelled by particularly dynamic levels of consumption and investment. This dynamism is buoyed up by various factors: (i) the solid performance of the labor market (with practically full employment) and the growth of real salaries; (ii) the persistence of favorable financial conditions based on continuing low interest rates and a strong dollar, which encourage consumption and investment, in addition to facilitating credit in a context in which private stakeholders have enjoyed healthy balance sheets; (iii) a significant sensation of increased wealth brought on by the appreciation in the value of residential property and financial assets over the last five years, and, overwhelmingly, (iv) by a clearly pro-cyclical fiscal policy that extended the current period of growth by confirming it as the longest (but also the shallowest) in the recent history of the United States (see Box 1.1-a). Nevertheless, as a result of the renewed strength of the dollar, decreased global dynamism and the tensions arising in relation to international trade, the external sector again deflected from the current trend toward growth by further entrenching the country's already extensive current account deficit.

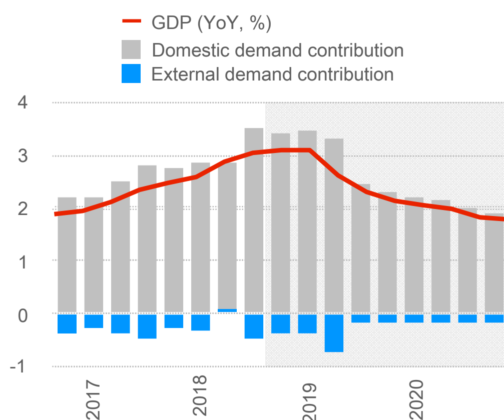
The year 2019 is expected to mark the definitive entry of the United States economy into an orderly, cyclical period of economic slowdown. Factors such as the output gap (positive), frictional unemployment, the gradual correction of confidence (Chart 1.2.1-d) and continued flattening of the interest rate curve, which has now virtually reversed, lead to the forecast that the US economy is approaching a change in cycle. Nevertheless, failing the advent of unexpected *shocks*, the change of cycle should be orderly. It is thus expected that economic growth in 2019 will continue to be positive (at 2.5%), although during the year we will see the diminution of all the above-mentioned factors that encouraged domestic demand, including the support provided by fiscal policies. For its part the external sector will continue to erode GDP growth as a result of a much lower rise of exports than of imports, in a context of reduced dynamism in the global economy, uncertainty concerning international trade, and the appreciation of the dollar (see Charts 1.2.1-a and 1.2.1-b and Table 1.2.1).

Inflation in 2018 remained just below 2%, with clear indications of strong core inflation but expectations that it would remain at a restrained level.

United States

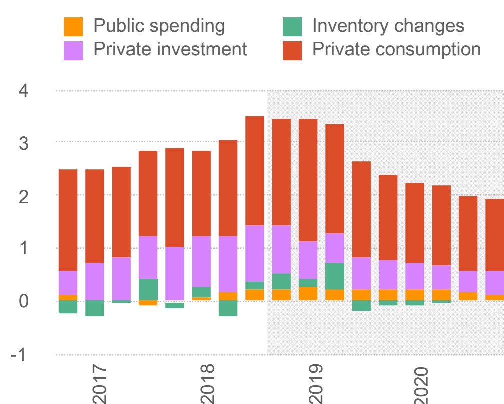
- **The US economy is maintaining growth, but is approaching a cycle change. It is expected that growth in activity will slow down to 2.5% in 2019.**
- **Monetary policy will gradually move toward neutrality, keeping the dollar appreciated.**
- **The change of cycle will be orderly and gradual, but with downside risk. The origin of any sharp adjustment would be in economic management and its interpretation by the markets.**

Chart 1.2.1-a
United States: GDP breakdown and forecasts



Source: MAPFRE Economic Research (based on data of the Federal Reserve)

Chart 1.2.1-b
United States: domestic demand breakdown and forecasts



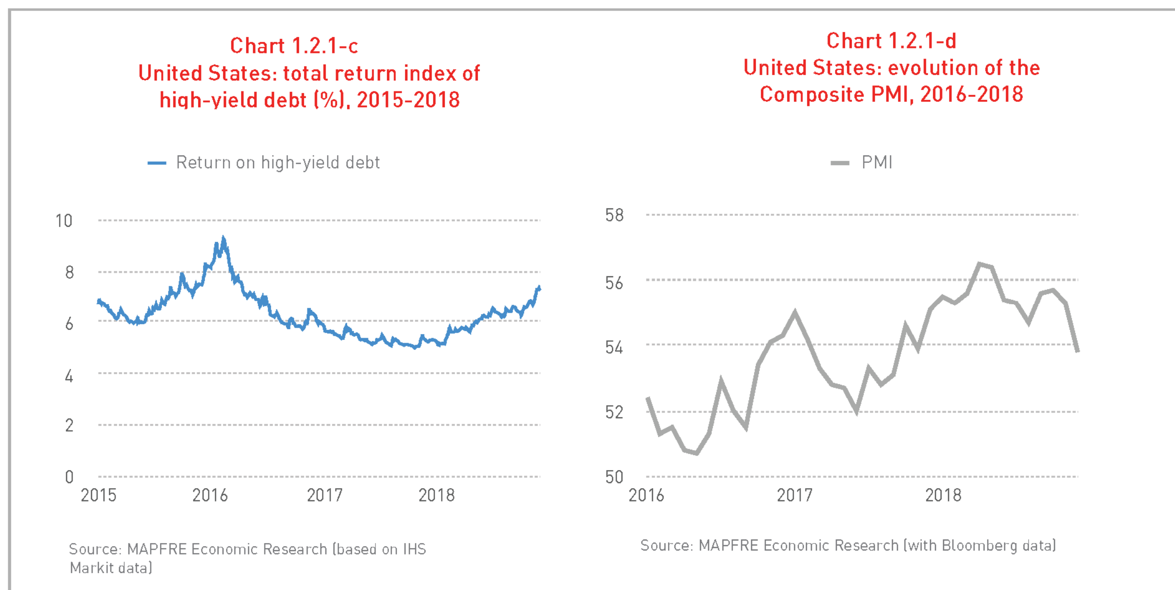
Source: MAPFRE Economic Research (based on data of the Federal Reserve)

Table 1.2.1
United States: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	2.4	2.9	1.6	2.2	2.9	2.5	1.9
Domestic demand contribution	2.2	3.7	1.8	2.6	3.2	2.9	2.1
External demand contribution	0.2	-0.8	-0.3	-0.3	-0.3	-0.4	-0.2
Private consumption contribution	2.0	2.5	1.9	1.8	1.9	2.0	1.5
Private investment contribution	0.6	0.7	0.3	0.8	1.0	0.6	0.5
Contribution made by public spending	-0.1	0.2	0.2	-0.0	0.2	0.2	0.2
Domestic demand (% YoY, average)	2.6	3.6	1.7	2.5	3.0	2.8	2.0
Total consumption (% YoY, average)	2.3	3.4	2.5	2.1	2.5	2.7	2.0
Private investment (% YoY, average)	4.9	3.3	1.7	4.0	4.9	2.8	2.2
Exports (YoY in %)	4.3	0.6	-0.1	3.0	4.1	1.9	2.7
Imports (YoY in %)	5.1	5.5	1.9	4.6	4.7	3.6	3.1
Unemployment rate (%, last quarter)	5.7	5.0	4.7	4.1	3.7	3.5	3.5
Inflation (% YoY, last quarter)	1.2	0.4	1.8	2.1	1.9	2.2	1.9
Fiscal balance (% of GDP)	-5.2	-4.8	-5.3	-4.1	-6.3	-6.4	-6.7
Trade balance (% of GDP)	-4.4	-4.4	-4.2	-4.3	-4.4	-4.4	-4.4
Fiscal stimulus (% GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-2.1	-2.2	-2.3	-2.3	-2.4	-2.7	-2.8
Official interest rate (end of period)	0.25	0.50	0.75	1.50	2.50	3.00	3.00
Short-term rate (end of period)	0.26	0.61	1.00	1.69	2.69	2.97	3.26
Long-term rate (end of period)	2.17	2.27	2.45	2.40	3.15	3.16	3.49
Exchange rate vs. USD (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Exchange rate vs. euro (end of period)	1.21	1.09	1.05	1.20	1.14	1.18	1.20
Private lending (% YoY, average)	7.7	2.3	3.5	5.2	3.9	3.9	3.7
Household lending (% YoY, average)	1.8	1.8	2.2	3.5	3.8	4.4	4.7
P.S. non-financial lending (% YoY, average)	4.8	5.7	5.5	5.9	7.5	5.6	3.9
P.S. financial lending (% YoY, average)	2.8	2.2	4.4	2.9	2.6	2.6	1.7
Savings rate (%, average)	7.3	7.6	6.7	6.7	6.6	5.7	5.7

Source: MAPFRE Economic Research (based on data of the Federal Reserve)
Forecast end date: January 8, 2019

Click here to access the interactive version of this information



For 2019, a slight acceleration of the overall rate of inflation is expected, which will keep prices firmly in line with the Federal Reserve's implicit objective.

After the monetary policy meeting of the Federal Reserve's Federal Open Market Committee (FOMC) in December 2018 (see Box 1.1-b), United States monetary policy entered a transition phase between laxity and neutrality. The FOMC raised interest rates by 25 basis points to 2.5%, which in terms of the cost of money represents a lax position in the context of the current cycle. Nevertheless, the reduction of Quantitative Easing (QE) continues progressively with the sale of assets worth 50 billion dollars every month. Taken together, both factors mark a neutral trend for the shadow interest rate for the United States economy. Given the current atmosphere of cyclical change, J. Powell has adopted an attitude of extreme caution and has based the Fed's *forward guidance* on neutrality of interest rates, which confirms our view that the rates are unlikely to surpass a neutral threshold that could be situated in the region of 3%. Two further rate hikes, of 25 basis points each, may therefore be expected during the transition period between the second and third quarters of the year. We anticipate that the interest rate will subsequently be maintained at 3% until after 2019. This approach is designed to achieve the following triple objective: (i) avoid causing a contraction in economic activity; (ii) gain monetary policy space in the eventuality of a crisis (with margin to reduce interest rates and asset sales), and (iii) start to reverse the pro-cyclicality which has predominated in recent years together with the smoothing of the lower fiscal stimulus.

This essentially neutral monetary strategy (even if it is perceptibly more restrictive than that of the eurozone, Japan and China) will maintain the attractiveness of the dollar and keep its value above its equilibrium exchange rate throughout 2019. The USD/EUR exchange rate is expected to be 1.18 at the end of 2019 (whereas the equilibrium exchange rate would be closer to 1.25). The dollar will also retain its attractiveness against the other emerging market currencies, especially in Latin America, but the pressure for its value to appreciate further will still dilute.

The risks for the United States economy arise essentially from the country's current economic policy and the particular moment in the economic cycle. Moreover, the high level of public debt, the problems with managing restrictions to the debt ceiling, the warnings from rating agencies such as Fitch or Moody's concerning the possibility of the country losing its AAA rating for sovereign debt, and the both direct and indirect effects of the recent trade wars, are all factors that drag down the weight of risk and could possibly transform the scenario of orderly cyclical adjustment referred to above into a slide toward recession.

1.2.2 Eurozone

Eurozone

- **The eurozone continued its cyclical sluggishness, entering even further into a growth rate below its potential.**
- **Monetary policy will remain in lax territory despite the gradual normalization of QE.**
- **Europe's risks are downward and are sovereign/financial in nature, but no signs of contagion are anticipated.**

The cyclical trend toward slack demand continues

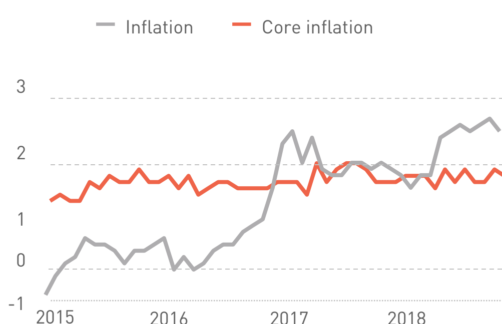
The eurozone has confirmed the slowdown already anticipated since the second quarter of 2018, after attaining a cyclical high point during the transition period between 2017 and 2018. The latest data for the third quarter in Germany (-0.2% QoQ) and Italy (-0.1% QoQ) anticipate a growth rate in the eurozone for 2018 that will be no higher than 1.9% (far below the 2.5% achieved in 2017), and given the earliest indicators such as the PMIs the slowdown is set to continue throughout 2019. This means that growth is not expected to exceed 1.7% during the course of the year, perpetuating a negative output gap (when the economy grows below its potential) that it has not been possible to eradicate, despite initial signs of recovery (see Charts 1.2.2-c and 1.2.2-d, and Table 1.2.2).

The above suggests that in Europe it is not so much a question of a change of cycle as of the continuation of the slack demand seen hitherto. The growth in the GDP anticipated for 2019 will thus be based on levels of consumption and investment that have been further undermined by falling expectations (and thus a climate of uncertainty), a fall-off in export markets (Chart 1.1-e) and a slowdown in job creation. In addition, the export market outside the eurozone will be weakened by the indirect effects of the current rhetoric concerning customs tariffs, and also by the appreciation of the euro (which is expected to appreciate in relation to all other currencies except the US dollar).

The greater level of slack demand will also result in a continuing level of core inflation (Chart 1.2.2-a) of in the region of 1.4% for 2019, although this is still far from the objective set by the European Central Bank (ECB). Barring external *shocks*, this will not result in an increase of more than 1.5% in overall inflation in the eurozone this year.

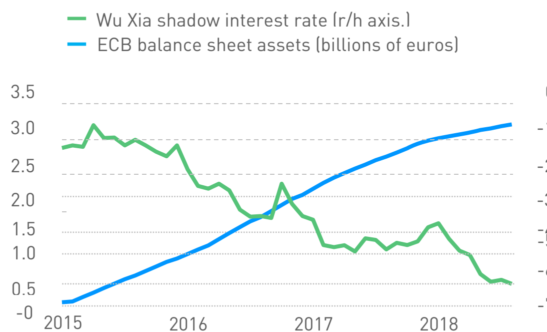
At its December meeting (see Box 1.1-b), the ECB announced the termination of its asset purchasing program and committed itself for the moment to reinvesting the principal, which means that the level of quantitative easing (QE) will remain stable. From the same meeting the message filtered out that the ECB was prepared to delay the rise in interest rates even after normalizing the deposit rate and starting

Chart 1.2.2-a
Eurozone: base and core inflation (% YoY), 2015-2018



Source: MAPFRE Economic Research (based on ECB data)

Chart 1.2.2-b
Eurozone: QE vs shadow interest rate, 2015-2018



Source: MAPFRE Economic Research (based on ECB and Atlanta Federal Reserve data)

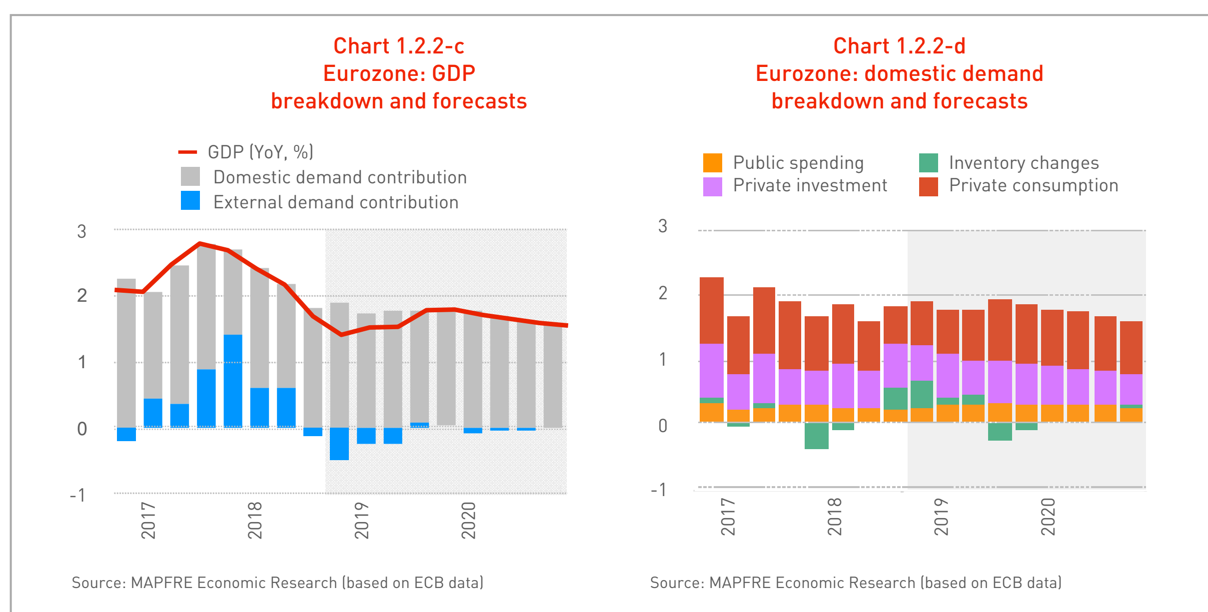


Table 1.2.2
Eurozone: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	1.4	2.0	1.9	2.5	1.9	1.7	1.6
Domestic demand contribution	0.8	2.2	2.3	1.7	1.8	1.7	1.7
External demand contribution	0.6	-0.2	-0.4	0.8	0.2	-0.1	-0.0
Private consumption contribution	0.5	1.0	1.0	1.0	0.7	0.8	0.8
Private investment contribution	0.1	0.9	0.8	0.6	0.6	0.6	0.5
Contribution made by public spending	0.2	0.3	0.4	0.2	0.2	0.3	0.3
Domestic demand (% YoY, average)	1.3	2.3	2.4	1.8	1.8	1.8	1.7
Total consumption (% YoY, average)	0.9	1.6	1.9	1.6	1.3	1.5	1.5
Private investment (% YoY, average)	1.7	4.6	4.0	2.9	3.1	3.0	2.6
Exports (YoY in %)	4.7	6.3	3.0	5.4	2.7	3.2	3.2
Imports (YoY in %)	4.8	7.4	4.2	4.1	2.6	3.7	3.5
Unemployment rate (%, last quarter)	11.4	10.5	9.7	8.7	8.0	7.6	7.3
Inflation (% YoY, last quarter)	0.2	0.2	0.7	1.4	1.8	1.4	1.7
Fiscal balance (% of GDP)	-2.5	-2.0	-1.6	-1.0	-0.3	-0.8	-0.8
Trade balance (% of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fiscal stimulus (% GDP)	0.1	0.3	0.6	1.0	1.5	1.0	0.9
Current account balance (% of GDP)	2.5	2.9	3.2	3.2	2.9	2.8	2.7
Official interest rate (end of period)	0.05	0.05	0.00	0.00	0.00	0.00	0.25
Short-term rate (end of period)	0.08	-0.13	-0.32	-0.33	-0.39	-0.15	0.18
Long-term rate (end of period)	1.34	1.20	1.04	0.91	1.19	1.68	2.32
Exchange rate vs. USD (end of period)	1.21	1.09	1.05	1.20	1.14	1.18	1.20
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	-0.2	0.9	1.7	2.7	2.7	3.2	3.5
P.S. non-financial lending (% YoY, average)	2.0	8.4	2.3	0.6	1.5	2.1	2.6
P.S. financial lending (% YoY, average)	6.3	17.2	3.0	-1.3	1.7	2.7	2.2
Savings rate (%, average)	12.6	12.5	12.4	11.9	12.1	12.3	12.2

Source: MAPFRE Economic Research (based on data of the ECB)
Forecast end date: January 8, 2019

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to sell off assets from its balance sheet (Chart 1.2.2-b). This is consistent with the sluggish price and activity levels henceforth anticipated. Faced with approaching sources of political uncertainty (Brexit and the elections to the European Council, Parliament and Commission) and the increasing tensions at national level that are starting to emerge (especially in Italy and France), the ECB may even be considering a reduction in its monetary normalization program, or at least the possibility of not raising interest rates until 2020 (a scenario that is central to this report).

The most obvious regional risks are arising from national conflicts, especially in Italy, but increasingly also in France, where the current political structure is again being called into question. Within the context of the European Union, Italy's rebellious stance toward its public deficit, combined with the solvency problems of its banking system, are leading to increases in its risk premium, despite the fact that for the moment the unease has not spread beyond its frontiers (Chart 1.1-c).

1.2.3 Spain

Economic growth slows down

Growth in Spain in the third quarter of 2018 was 2.5%, far below the peak value attained in the period from late 2017 to early 2018. This figure confirmed the forecast made at the start of the year that the Spanish economy would grow by nearly 2.6% during 2018 (see Charts 1.2.3-a and 1.2.3-b, and Table 1.2.3).

This growth was achieved entirely thanks to a major increase in domestic demand, based not only on family consumption but also on private investment in both equipment and property. Employment grew (by +500,000 jobs), in a context of: (i) high structural unemployment, but with salaries rising faster than productivity; (ii) the recourse to savings; (iii) a growing effect of wealth creation arising from the recovery of the residential property sector (the prices of which rose by around 4.5% in 2018); and (iv) fiscal support, all of which sustained the growth in consumption. In addition, continuing favorable financial conditions and the need to renew production equipment supported an increase in capital expenditure, even in the current context of political uncertainty. In short, both sectors contributed to growth in similar proportions during the year. For its part, public spending also made a positive contribution that was slightly higher than the average over the previous five years.

Advanced indicators (PMIs), in terms of both services and manufacturing, picked up during the final quarter of the year, remaining solid symbols of expansion (Chart 1.2.3-c), which enabled us to confirm that Spain still maintained its relative dynamism compared with the rest of the eurozone, although this growth was three tenths below that attained in 2018 (equivalent to a rate of job creation approximately 10% lower than the pace of job creation registered over the last three years) and meant a downward revision with regard to what had been anticipated in the past. This situation is, however, in line with the cyclical slowdown experienced elsewhere in the eurozone. The lower growth rate will above all be caused by the slowdown in consumption and investment. In the case of consumption, this will be because the positive *shocks* experienced in 2018 will lose their force, and in the case of investment because the current political and budgetary situation will sooner or later end by draining investors' confidence (Chart 1.2.3-d). In this context, it is anticipated that inflation will continue to rise by under 2% (a desirable objective), with core inflation close to that of the eurozone at around 1%.

Spain

- **The growth of the Spanish economy will slow down in line with the external environment.**
- **GDP growth of 2.3% is predicted in 2019. Job creation will experience a similar slowdown.**
- **The structural vulnerabilities of the economy persist and alert us regarding future fiscal sustainability.**
- **The political climate remains tense, but for the moment the possibility of early elections is being disregarded.**

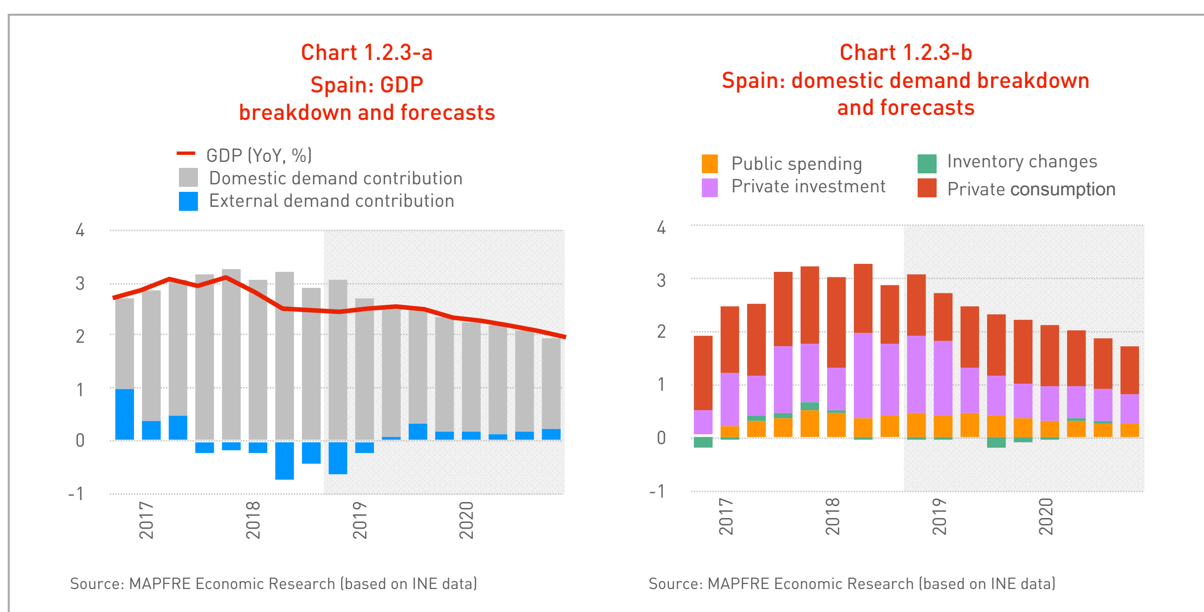

Table 1.2.3
Spain: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	1.4	3.6	3.2	3.0	2.6	2.3	2.1
Domestic demand contribution	1.3	3.8	2.3	2.8	3.0	2.2	1.9
External demand contribution	0.1	-0.2	0.8	0.1	-0.5	0.1	0.2
Private consumption contribution	0.8	1.7	1.6	1.4	1.3	1.0	1.0
Private investment contribution	0.5	1.4	0.6	1.0	1.3	0.9	0.6
Contribution made by public spending	-0.1	0.4	0.2	0.4	0.4	0.4	0.3
Domestic demand (% YoY, average)	1.9	4.0	2.4	3.0	3.2	2.5	2.0
Total consumption (% YoY, average)	1.0	2.8	2.4	2.4	2.3	2.1	1.8
Private investment (% YoY, average)	4.7	6.7	2.9	4.8	6.2	4.1	2.6
Exports (YoY in %)	4.3	4.2	5.2	5.2	1.7	2.9	3.6
Imports (YoY in %)	6.6	5.4	2.9	5.6	3.6	2.9	3.4
Unemployment rate (%, last quarter)	23.7	20.9	18.6	16.6	14.7	13.3	12.4
Inflation (% YoY, last quarter)	-0.5	-0.3	1.0	1.4	1.6	1.3	1.6
Fiscal balance (% of GDP)	-6.0	-5.3	-4.5	-3.1	-2.7	-2.2	-1.6
Trade balance (% of GDP)	-2.2	-2.0	-1.4	-1.9	-2.6	-2.4	-2.2
Fiscal stimulus (% GDP)	-2.5	-2.2	-1.7	-0.5	-0.2	0.3	0.8
Current account balance (% of GDP)	1.0	1.1	2.3	1.9	1.0	0.8	0.8
Official interest rate (end of period)	0.05	0.05	0.00	0.00	0.00	0.00	0.25
Short-term rate (end of period)	0.08	-0.13	-0.32	-0.33	-0.38	-0.15	0.18
Long-term rate (end of period)	1.61	1.77	1.35	1.51	1.54	1.93	2.54
Exchange rate vs. USD (end of period)	1.21	1.09	1.05	1.20	1.14	1.18	1.20
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	-4.9	-3.6	-2.2	-1.5	-0.2	1.1	2.9
P.S. non-financial lending (% YoY, average)	-4.6	-2.8	-2.6	-0.5	-2.2	1.7	2.1
P.S. financial lending (% YoY, average)	-1.4	-6.6	-27.5	-12.2	5.7	6.5	5.8
Savings rate (%, average)	9.3	8.8	8.0	5.7	4.6	4.7	4.3

Source: MAPFRE Economic Research (based on data of the INE)
Forecast end date: January 8, 2019

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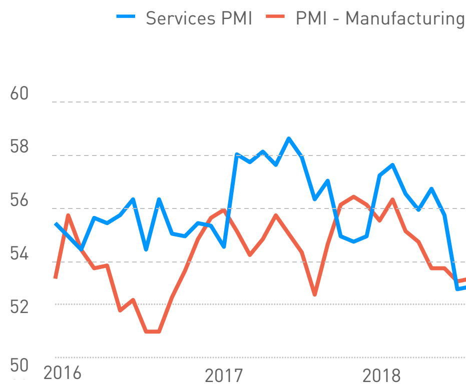
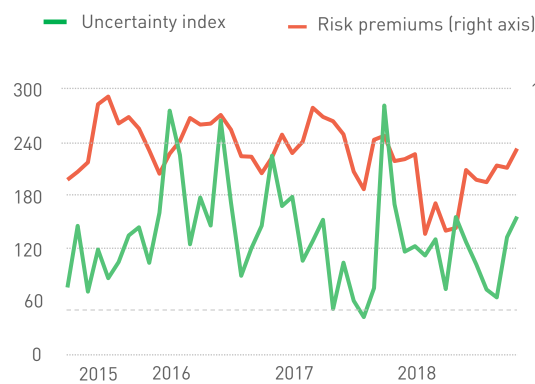
Chart 1.2.3-c
Spain Services and manufacturing PMI, 2016-2018



Source: MAPFRE Economic Research (based on IHS Markit data)

Chart 1.2.3-d
Spain: index (normalized) of uncertainty of economic policy and risk premium, 2015-2018



Source: MAPFRE Economic Research (based on Bloom, et al. 2017 and ECB data)

The risks for the Spanish economy are mainly those arising from the cooling down of its trading partners, and also from a hardening of financial conditions caused by the end of the ECB's program of stimuli, although we give little weight to the latter factor. An increase in risk premiums will have a greater effect, whether it be through contagion from other peripheral countries (in their attempt to break the fiscal discipline agreed through the euro countries' stability agreement), or through the alignment of vulnerable parties contracted in the past, the most significant of which would be the sustainability of public accounts. Despite the increase in revenue foreseen for this year, the increase in costs is also considerable. The resulting deficit, although contained, is based on forecasts for growth that after 2019 may appear optimistic, especially in relation to structural reforms (both fiscal and labor-related) that are either half-completed or reversed. In this sense, the increase in public sector salaries, the indexing of pensions and the other recent measures of a fiscal nature may constitute a challenge for the Spanish economy in the medium term.

On the political front, the government has not hitherto been able to obtain sufficient support to approve its budgets, and the likeliest outcome is that in 2019 it will have to extend the previous budgets. For the moment early elections are not anticipated, but increasing discontent on the part of the government's Catalan partners could put pressure on the existing fragile balance. In addition, there will be European and regional elections, which will constitute a major test for the performance of the present government.

1.2.4 Germany

Signs of a slowdown

Germany is aligning itself with the period of slowdown that will be faced by all the eurozone economies. Various monitoring indicators have for some time suggested a slowdown in production capacity. In particular, the manufacturing PMI had registered fall-offs during the course of the year, from the peak of 63.3 achieved in December 2017 down to 51.8 recorded in November 2018. Retail sales generally recorded year-on-year changes below those observed in previous years, while

Germany

- **Germany is showing signs of slowing down.**
- **The labor market will continue its convergence toward full employment, with an expected increase in salaries in real terms.**
- **The new regulations threaten German automobile production.**

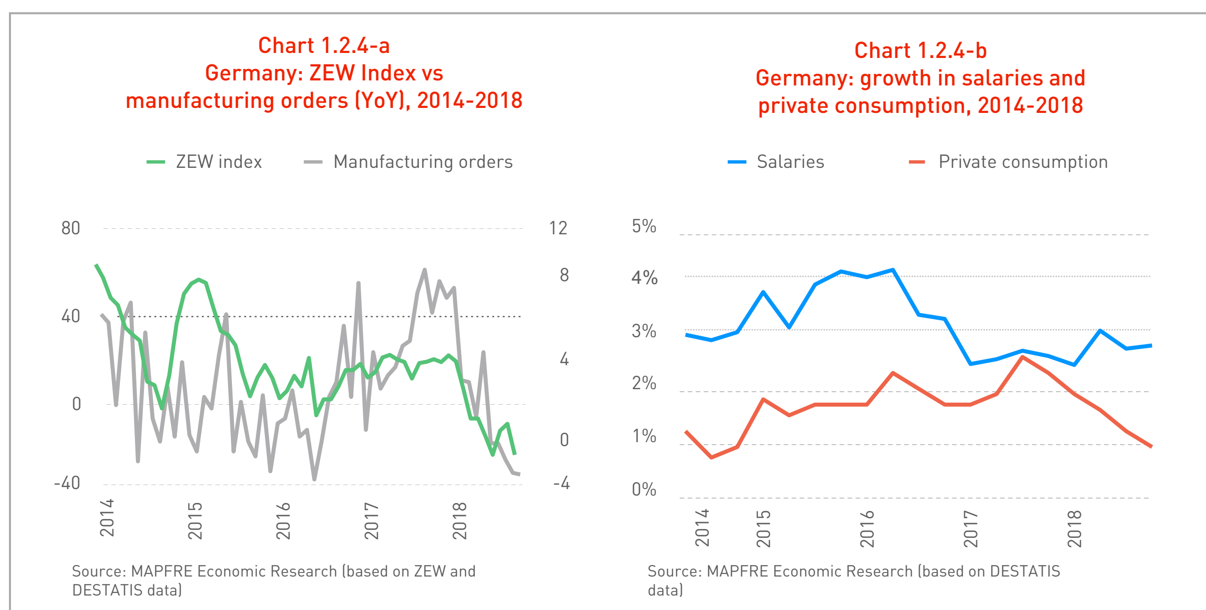


Chart 1.2.4-a
Germany: ZEW Index vs manufacturing orders (YoY), 2014-2018

Source: MAPFRE Economic Research (based on ZEW and DESTATIS data)

Chart 1.2.4-b
Germany: growth in salaries and private consumption, 2014-2018

Source: MAPFRE Economic Research (based on DESTATIS data)

the consumer confidence index fell from 11 points (February 2018) to 10.6 (November 2018).

These signs of slowdown were confirmed in the third quarter of 2018, when growth fell back to -0.2% QoQ and 1.2% YoY, much lower than analysts' forecasts. Despite the above, the data collected by the ZEW survey of investors during its poll in December 2018 was a positive surprise (-17 observed against -25 expected), suggesting that the contraction of the third quarter may have been an isolated event (Chart 1.2.4-a).

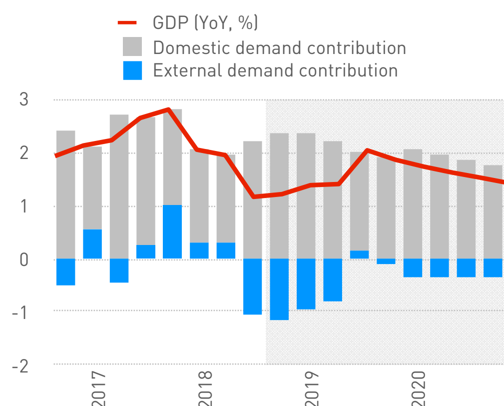
The new regulations concerning polluting emissions (the WLTP emissions examination) has had a negative effect on the certification of German-produced vehicles, compromising the growth of industrial production for the second half of 2018. As a result, the registration of new automobiles underwent a fall of -9.9% in November 2018. Added to the above, the effects of a more protectionist trade policy from across the Atlantic and a fall in purchasing power in the country's export markets represented major factors leading to the slowdown of the German economy. All of these elements came into play to form a scenario in which we hope that 2018 will be found to have come to a close with growth of 1.6% and 2019 with growth of 1.7% (see Charts 1.2.4-a and 1.2.4-b, and Table 1.2.4).

With regard to prices, the inflation data for November 2018 (2.3% YoY) show a convergence toward the ECB's policy objective. For its part, core inflation (excluding energy prices) stood at 1.5%, showing that the rate of consumption was far behind the ideal levels postulated by the various European agencies.

With regard to the labor market, it continued its trend toward full employment, with an unemployment rate that stood at 3.3% in November 2018. Combined with the above, the data for salary increases suggest a changing trend. This saw salaries increase by 1.5% in September 2018, compared with 0.5% in the previous year (Chart 1.2.4-b).

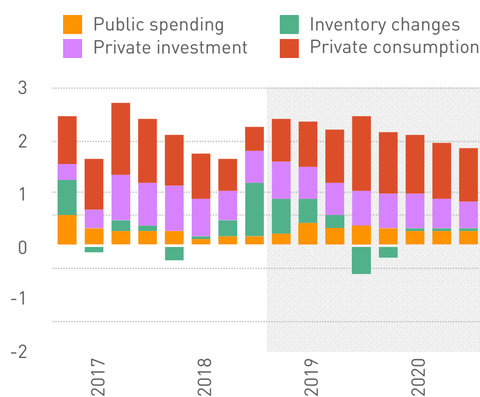
In the political world, Angela Merkel decided to step aside after a series of defeats in regional elections. At the same time, the former general secretary of the CDU, Annegret Kramp-Karrenbauer, was elected to succeed Mrs. Merkel as the president of the party. Kramp-Karrenbauer won by only a narrow victory over her opponent Friedrich Merz, the former leader of the conservative bloc in the German parliament.

Chart 1.2.4-c
Germany: GDP breakdown and forecasts



Source: MAPFRE Economic Research (based on DESTATIS data)

Chart 1.2.4-d
Germany: domestic demand breakdown and forecasts



Source: MAPFRE Economic Research (based on DESTATIS data)

Table 1.2.4
Germany: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	2.2	1.5	2.2	2.5	1.6	1.7	1.6
Domestic demand contribution	1.0	1.3	2.8	2.1	2.0	2.1	1.9
External demand contribution	1.2	0.2	-0.6	0.3	-0.4	-0.4	-0.3
Private consumption contribution	0.6	0.9	1.0	1.1	0.7	1.1	1.0
Private investment contribution	0.4	0.2	0.7	0.7	0.6	0.6	0.5
Contribution made by public spending	0.3	0.5	0.8	0.3	0.2	0.4	0.3
Domestic demand (% YoY, average)	1.6	1.4	3.0	2.3	2.1	2.2	2.0
Total consumption (% YoY, average)	1.2	1.9	2.4	1.9	1.1	2.0	1.8
Private investment (% YoY, average)	3.9	1.0	3.4	3.6	3.2	3.1	2.6
Exports (YoY in %)	4.6	4.8	2.1	5.3	2.3	3.5	3.5
Imports (YoY in %)	3.6	5.2	4.0	5.3	3.5	5.0	4.7
Unemployment rate (%, last quarter)	6.6	6.3	6.0	5.5	5.1	4.9	5.0
Inflation (% YoY, last quarter)	0.2	0.3	1.7	1.7	2.1	1.5	1.8
Fiscal balance (% of GDP)	0.6	0.8	0.9	1.0	2.0	1.0	0.6
Trade balance (% of GDP)	7.8	8.5	8.4	8.2	7.3	7.0	6.7
Fiscal stimulus (% GDP)	2.2	2.2	2.0	2.0	2.7	2.3	1.6
Current account balance (% of GDP)	7.5	9.0	8.5	8.0	7.6	7.2	6.8
Official interest rate (end of period)	0.05	0.05	0.00	0.00	0.00	0.00	0.25
Short-term rate (end of period)	0.08	-0.13	-0.32	-0.33	-0.39	-0.15	0.18
Long-term rate (end of period)	0.54	0.63	0.11	0.42	0.40	0.83	1.47
Exchange rate vs. USD (end of period)	1.21	1.09	1.05	1.20	1.14	1.18	1.20
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	1.1	1.9	2.8	3.2	3.6	5.1	5.6
P.S. non-financial lending (% YoY, average)	2.7	1.8	2.1	4.3	7.7	4.5	3.6
P.S. financial lending (% YoY, average)	-7.6	8.4	1.9	-1.2	1.8	3.2	3.6
Savings rate (%, average)	9.4	9.7	10.0	9.8	10.2	10.0	9.7

Source: MAPFRE Economic Research (based on data of the DESTATIS)
Forecast end date: January 8, 2019

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1.2.5 Italy

Growth forecasts are revised downward

The Italian economy caused surprise by a fall in activity in the third quarter (-0.1% QoQ), setting the YoY rate at 0.7%. The slowdown of growth was due to a fall in private consumption (-0.1% QoQ), and above all to a fall in investment (-1.1% QoQ). These figures show that the cost of the increase in country risk and financing problems are starting to crystallize (Charts 1.2.5-a and 1.2.5-b). In a context of the highest level of euroskepticism since Italy joined the European Union (caused mainly by a slowdown in the growth of GDP per capita, now close to 0%, and the data for youth unemployment), the criticisms of European austerity made by the new Italian government, already outlined in the electoral campaigns of the "Lega" and "M5E" movements, have taken shape in the form of a budget that has defied Brussels by its severe public deficit. This results in an estimated public deficit of 2.04%, following adjustment from an initial 2.4%, applied to avoid an excessive deficit procedure. All the above is against the backdrop of the relative worsening of the political situation in France where President Macron has announced an increase in public spending so as to deal with the "yellow vest" protest movement, which could considerably increase the French deficit.

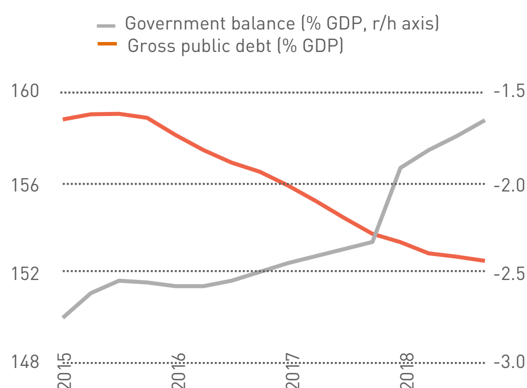
Italy

- In the third quarter of 2018, the growth of the Italian economy contracted by -0.1% QoQ. The expectations of downward growth are unsettling the market due to their implications for the public accounts.
- It appears that the Italian government has made concessions to Brussels' requirements in light of the possible activation of the excessive deficit procedure.

The debt markets remain uncertain as a result of the anxiety of investors faced by the tensions between the Italian government and Brussels. This political instability resulted in Italian bonds reaching their highest point since the European debt crisis of over a decade ago, reaching 3.7% at mid-October. Currently, the yield stands at 2.76%, after Italy reviewed its budget. To all the above is added the possibility that the Italian populist parties may win the elections to the European Parliament next May, a prospect that unsettles investors (Chart 1.2.5-b).

Our forecast for Italian growth is that there will be a continuation of slack demand and a return to the growth levels registered toward the middle of this decade. Growth of 0.4% is therefore predicted in 2019, reflecting a slowdown from the 0.9% we predicted for 2018

Chart 1.2.5-a
Italy: government deficit and public debt, 2015-2018

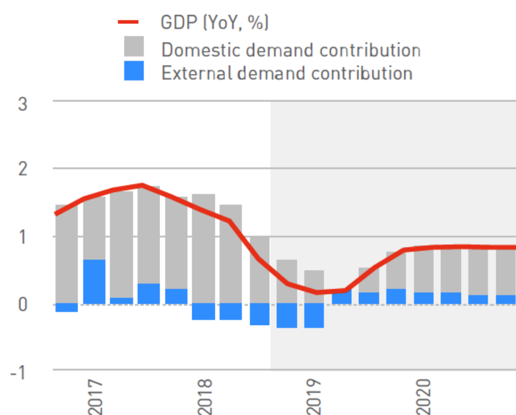


Source: MAPFRE Economic Research (based on Eurostat and OECD data)

Chart 1.2.5-b
Italy: risk premium, 2015-2018

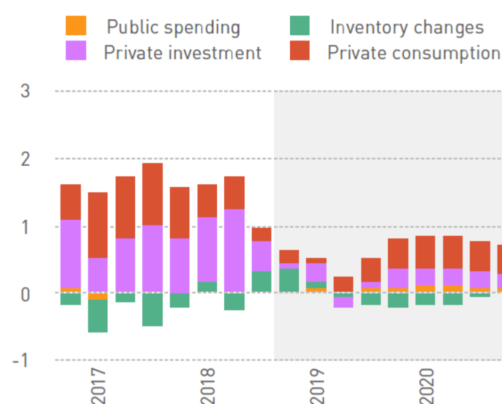
Source: MAPFRE Economic Research (based on Bloomberg data)

Chart 1.2.5-c
Italy: GDP breakdown and forecasts



Source: MAPFRE Economic Research (based on DESTATIS data)

Chart 1.2.5-d
Italy: domestic demand breakdown and forecasts



Source: MAPFRE Economic Research (based on DESTATIS data)

Table 1.2.5
Italy: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	0.2	0.8	1.3	1.6	0.9	0.4	0.8
Domestic demand contribution	-0.1	1.4	1.6	1.3	1.2	0.4	0.7
External demand contribution	0.3	-0.6	-0.4	0.3	-0.3	0.1	0.1
Private consumption contribution	0.1	1.1	0.8	0.9	0.3	0.3	0.5
Private investment contribution	-0.4	0.3	0.6	0.8	0.7	0.1	0.2
Contribution made by public spending	-0.1	-0.1	0.1	-0.0	0.0	0.1	0.1
Domestic demand (% YoY, average)	0.3	1.4	1.7	1.4	1.2	0.4	0.7
Total consumption (% YoY, average)	-0.0	1.3	1.0	1.1	0.5	0.4	0.7
Private investment (% YoY, average)	-2.1	1.9	3.6	4.4	3.8	0.7	1.3
Exports (YoY in %)	2.4	4.1	2.3	6.3	0.8	3.2	3.1
Imports (YoY in %)	3.0	6.7	3.9	5.6	1.9	3.2	2.9
Unemployment rate (%, last quarter)	12.8	11.5	11.8	11.0	10.7	10.8	10.5
Inflation (% YoY, last quarter)	0.1	0.2	0.1	0.9	1.6	1.2	1.6
Fiscal balance (% of GDP)	-3.0	-2.6	-2.5	-2.4	-1.8	-2.6	-2.3
Trade balance (% of GDP)	2.6	2.5	2.9	2.8	2.3	2.5	2.8
Fiscal stimulus (% GDP)	1.6	1.5	1.4	1.4	2.0	1.1	1.4
Current account balance (% of GDP)	1.9	1.5	2.5	2.8	2.6	2.9	2.9
Official interest rate (end of period)	0.05	0.05	0.00	0.00	0.00	0.00	0.25
Short-term rate (end of period)	0.08	-0.13	-0.32	-0.33	-0.39	-0.15	0.18
Long-term rate (end of period)	1.88	1.61	1.82	2.00	3.23	3.81	4.46
Exchange rate vs. USD (end of period)	1.21	1.09	1.05	1.20	1.14	1.18	1.20
Exchange rate vs. euro (end of period)	n/r	n/r	n/r	n/r	n/r	n/r	n/r
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	-1.0	-0.3	0.4	1.3	2.1	3.8	4.0
P.S. non-financial lending (% YoY, average)	-2.5	-1.9	-2.1	-2.6	-1.1	1.4	3.7
P.S. financial lending (% YoY, average)	-30.2	-1.5	-0.9	-8.8	-7.3	2.4	6.3
Savings rate (%, average)	11.0	10.7	10.3	9.4	9.5	10.2	10.4

Source: MAPFRE Economic Research (based on data of the ISTAT)
Forecast end date: January 8, 2019

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(see Charts 1.2.5-c and 1.2.5-d, and Table 1.2.5).

In this climate of tension as a result of Italy's excessive public deficit (Chart 1.2.5-a), one of the factors requiring vigilance with regard to 2019 is the cooling off of economic growth and its effect on tax revenues. It is anticipated that the fall in growth will be caused mainly by a reduction in domestic demand. However, this trend will be partially counterbalanced by a better performance in the external sector. In addition, a drastic reduction is also foreseen in the contribution of investments to GDP, falling from 0.7% in 2018 to 0.1% in 2019.

Meanwhile, inflation in Italy in November stood at 1.7% and is expected to fall to 1.2% for 2019. The manufacturing sector was marked by a -6.3% reduction in the registration of automobiles. Furthermore, the manufacturing PMI stood at 48.6 in November, thus registering two consecutive months below the 50 mark, indicating that the majority of those polled are pessimistic about the prospects for economic performance. By contrast, the PMI for the building industry continues to rise, reaching 55 points, while property prices remain stable and below 2016 levels.

1.2.6 United Kingdom

The uncertainty concerning Brexit continues to affect growth

The economy of the United Kingdom displayed a growth level of 1.5% YoY in the third quarter, higher than that registered in previous quarters. Nevertheless, early indicators show a loss of dynamism (Chart 1.2.6-c), leading to an estimate that growth in 2018 could close the year at around 1.2% YoY. The slowing down of private investment and the postponement of consumption decisions due to the uncertainty caused by Brexit continue to affect growth, which could be boosted by greater fiscal flexibility and public spending contributions during the course of 2019.

Unemployment levels remain very low (close to 4%) causing the upturn in salaries (3.3% in October) to register the highest growth rate since 2009. It is thus expected that growth in 2019 will stand at a rate similar to that of 2018, at around 1.2% YoY (see Charts 1.2.6-a and 1.2.6-b, and Table 1.2.6).

For its part, inflation stood at 2.3% in November, one tenth of a point lower than in October. This reduction reflects a fall in energy prices in November, and the freezing of the prices of food and alcoholic drinks. In 2019, inflation is expected to fall below the objective set by the Bank of England, largely due to the reduction of oil price forecasts, combined with greater uncertainty concerning house prices (Chart 1.2.6-d) and a pound sterling that could continue to lose value.

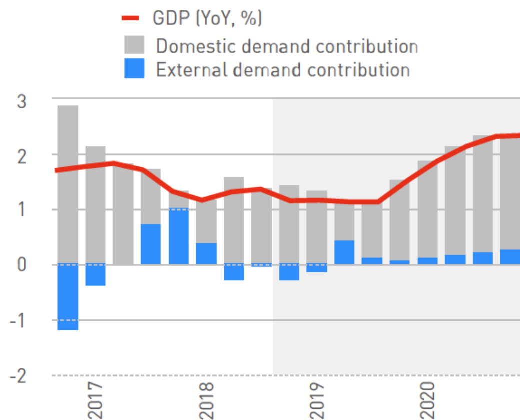
The Bank of England voted unanimously to maintain interest rates at 0.75%, to continue with its program of purchasing private assets, and to support without change a level of GBP 435 billion of public debt. The hardening of some financial conditions, the relaxation of inflation prospects and the growing intense uncertainty concerning Brexit, could lead to a more hesitant attitude at the next monetary policy meetings of the British central bank.

Finally, the agreement proposed for Brexit does not seem to represent a firm intention to leave the European Union (EU). It commits the United Kingdom to complying with existing EU regulations and legislation while no longer being able to influence its formulation, which implies that it is does not essentially constitute leaving at all, therefore the deal voted on by

United Kingdom

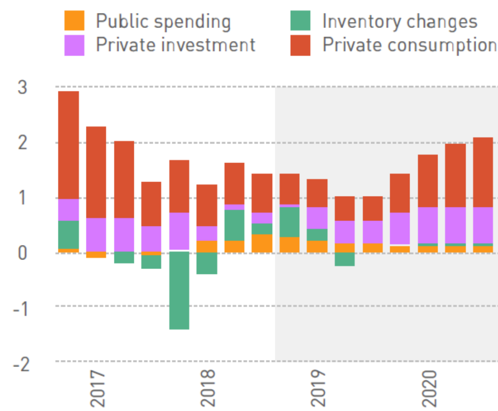
- A slowdown in investment and a deferral of consumption decisions would put growth in 2018 at 1.2%.
- The uncertainty around Brexit is increasing.
- The Bank of England is maintaining its monetary policy unchanged.

Chart 1.2.6-a
United Kingdom: GDP breakdown and forecasts



Source: MAPFRE Economic Research (based on Office for National Statistics data)

Chart 1.2.6-b
United Kingdom: domestic demand breakdown and forecasts



Source: MAPFRE Economic Research (based on Office for National Statistics data)

Table 1.2.6
United Kingdom: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	2.9	2.4	1.8	1.7	1.2	1.2	2.2
Domestic demand contribution	2.6	2.3	2.4	1.3	1.3	1.1	2.0
External demand contribution	0.3	0.0	-0.6	0.4	-0.1	0.1	0.2
Private consumption contribution	1.3	1.7	2.0	1.2	0.7	0.5	1.2
Private investment contribution	0.7	0.6	0.4	0.6	0.2	0.5	0.6
Contribution made by public spending	0.4	0.3	0.1	-0.0	0.2	0.2	0.1
Domestic demand (% YoY, average)	3.6	2.4	2.4	1.3	1.3	1.1	2.0
Total consumption (% YoY, average)	2.1	2.4	2.7	1.4	1.1	0.8	1.6
Private investment (% YoY, average)	7.3	3.4	2.3	3.4	1.0	2.7	3.7
Exports (YoY in %)	2.3	4.5	1.0	5.4	-0.3	2.2	3.4
Imports (YoY in %)	3.8	5.5	3.3	3.3	-0.3	1.7	2.8
Unemployment rate (%, last quarter)	5.7	5.1	4.8	4.4	4.0	4.1	4.0
Inflation (% YoY, last quarter)	0.9	0.1	1.2	3.0	2.2	1.2	2.0
Fiscal balance (% of GDP)	-5.4	-4.2	-2.9	-1.9	-1.8	-1.6	-1.1
Trade balance (% of GDP)	-6.6	-6.2	-6.7	-6.7	-6.4	-6.1	-6.1
Fiscal stimulus (% GDP)	-2.7	-2.0	-0.5	0.8	0.8	1.0	1.5
Current account balance (% of GDP)	-4.9	-4.9	-5.2	-3.9	-3.3	-2.3	-2.1
Official interest rate (end of period)	0.50	0.50	0.25	0.50	0.75	1.00	1.50
Short-term rate (end of period)	0.56	0.59	0.37	0.52	0.66	0.64	1.47
Long-term rate (end of period)	1.82	2.02	1.28	1.25	1.30	1.64	2.32
Exchange rate vs. USD (end of period)	1.56	1.48	1.23	1.35	1.35	1.41	1.45
Exchange rate vs. euro (end of period)	1.28	1.36	1.17	1.13	1.14	1.13	1.16
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	2.1	3.3	4.4	4.5	2.7	3.4	3.4
P.S. non-financial lending (% YoY, average)	-3.3	-1.9	6.2	6.1	8.3	2.3	2.4
P.S. financial lending (% YoY, average)	-9.1	-13.6	7.4	11.9	4.4	4.8	5.0
Savings rate (%, average)	8.6	9.4	6.8	4.4	4.5	4.7	4.4

Source: MAPFRE Economic Research (based on data of the Office for National Statistics)
Forecast end date: January 8, 2019

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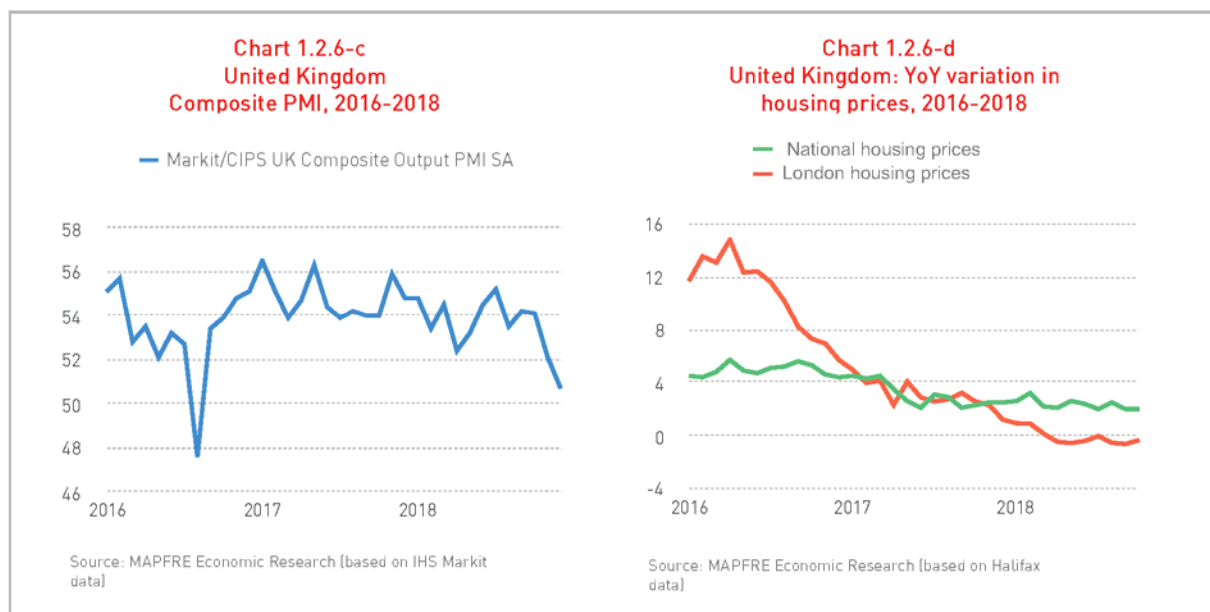


Parliament was overwhelmingly rejected. We appear to be facing a deadlock that could be broken by the opening up of various different scenarios, including the fall of the government, a second referendum or a no-deal exit from the EU, with the European Court of Justice stressing that the United Kingdom can unilaterally decide to remain in the EU.

1.2.7 Japan

Current conditions provoke an economic slowdown

The Japanese economy underwent a strong downturn in the third quarter, from the 1.4% growth registered in the second quarter to 0% YoY in the following quarter. This 2.5% contraction during the quarter was due to a fall in private consumption (-1.4% QoQ), public spending (-0.6% QoQ), non-residential investment (-9.1% QoQ) and exports (-2,8% QoQ). This pattern of behavior is partly attributable to shocks in the supply system due to the disruption caused by the natural disasters occurring in the country, but also due to the effects of an external environment in economic slowdown. A growth level of 0.8% can thus be expected for the whole of 2018, together with a slight recovery to 1% for 2019 (see Charts 1.2.7-a and 1.2.7-b, and Table 1.2.7).

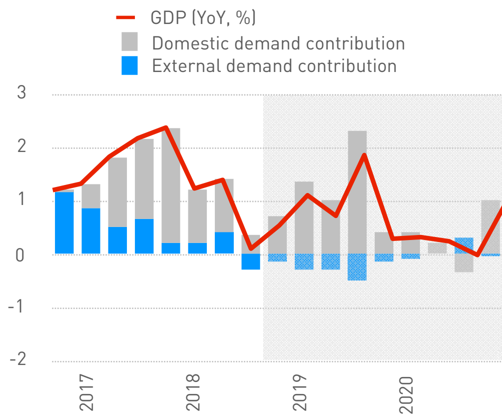
Despite the latest data, the economy is expected to improve slightly given its good fundamentals and a labor market with close to full employment (it is important to note the government's recent approval of new visas for low-skilled foreigners, which could drive salary growth). Another factor that could make a positive contribution is the foreseeable future fiscal policy to encourage growth (despite the increases in consumption taxes), which will lead consumers to anticipate certain purchases (noting the growth in the first three quarters and the loss of dynamism in the fourth quarter). The government, as in the case of previous tax rises, intends to adopt certain stimulatory measures in order to counter a possible fall in private consumption. These measures may include an increase in investment and infrastructure (Chart 1.2.7-d).

Inflation in November stood at a low level (around 0.9%), below expectations of 1.0%. In 2019, we expect inflation in the region of 2.1%,

Japan

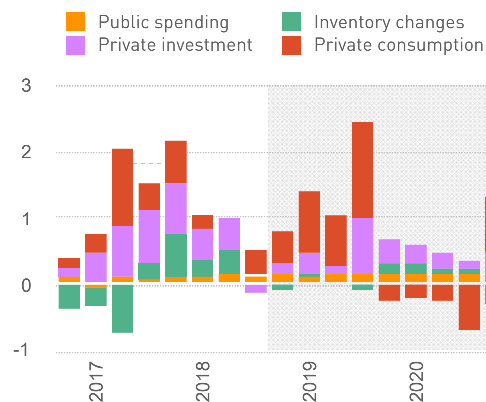
- **Slowing of the Japanese economy in the third quarter due to the natural disasters devastating the country.**
- **Opening-up of the labor market and fiscal stimuli to boost consumption.**
- **The Bank of Japan is maintaining its monetary policy unchanged.**

Chart 1.2.7-a
Japan: GDP breakdown and forecasts



Source: MAPFRE Economic Research (with Statistics Bureau data)

Chart 1.2.7-b
Japan: domestic demand breakdown and forecasts



Source: MAPFRE Economic Research (with Statistics Bureau data)

Table 1.2.7
Japan: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	0.3	1.3	0.6	1.9	0.8	1.0	0.4
Domestic demand contribution	-0.3	0.9	0.0	1.4	0.8	1.3	0.3
External demand contribution	0.6	0.4	0.6	0.6	0.0	-0.3	0.0
Private consumption contribution	-0.5	-0.1	-0.1	0.6	0.3	0.7	-0.1
Private investment contribution	0.4	0.4	-0.1	0.7	0.2	0.4	0.2
Contribution made by public spending	0.1	0.3	0.3	0.1	0.1	0.1	0.1
Domestic demand (% YoY, average)	0.3	0.9	0.0	1.4	0.8	1.3	0.3
Total consumption (% YoY, average)	-0.6	0.3	0.3	0.9	0.5	1.1	0.1
Private investment (% YoY, average)	3.0	1.7	-0.3	3.0	1.0	1.8	1.0
Exports (YoY in %)	9.3	3.0	1.7	6.8	3.3	2.5	2.7
Imports (YoY in %)	8.4	0.7	-1.6	3.4	3.0	3.9	2.2
Unemployment rate (%, last quarter)	3.5	3.3	3.1	2.7	2.3	2.4	2.4
Inflation (% YoY, last quarter)	2.5	0.2	0.3	0.6	0.9	2.1	1.1
Fiscal balance (% of GDP)	-5.4	-3.6	-3.4	-3.7	-3.4	-3.5	-3.1
Trade balance (% of GDP)	-2.0	-0.2	1.0	0.9	0.4	0.1	0.2
Fiscal stimulus (% GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	0.8	3.1	3.8	4.0	3.5	3.3	3.3
Official interest rate (end of period)	0.07	0.04	-0.06	-0.06	-0.06	-0.09	-0.07
Short-term rate (end of period)	0.11	0.08	-0.05	-0.02	-0.10	-0.07	-0.05
Long-term rate (end of period)	0.33	0.27	0.04	0.05	0.10	0.06	0.07
Exchange rate vs. USD (end of period)	119.85	120.27	116.78	112.69	112.51	109.61	109.79
Exchange rate vs. euro (end of period)	145.51	130.94	123.10	135.15	127.70	128.90	131.75
Private lending (% YoY, average)	2.2	2.1	2.2	4.5	3.0	3.6	2.5
Household lending (% YoY, average)	0.8	1.2	1.3	1.8	2.2	0.5	0.6
P.S. non-financial lending (% YoY, average)	0.4	0.5	2.1	2.6	1.6	1.8	1.7
P.S. financial lending (% YoY, average)	8.5	7.7	-0.3	7.9	3.0	1.1	1.8
Savings rate (%, average)	-0.4	0.8	2.6	3.0	4.1	2.6	2.7

Source: MAPFRE Economic Research (based on data of the Statistics Bureau)
Forecast end date: January 8, 2019

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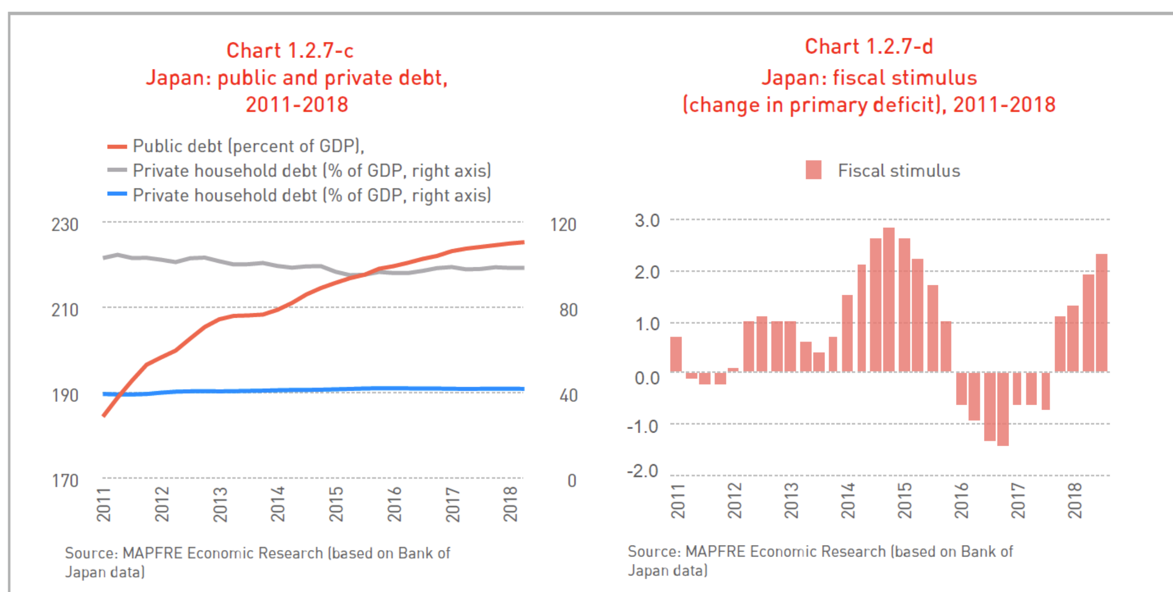


driven by fiscal stimuli and the upward pressures on salaries that may be caused by the recent opening of the labor market in response to the shortage of low-skilled workers against a backdrop of almost full employment.

In addition, as expected, the Bank of Japan left the official interest rates unchanged at its last meeting in December, indicating that it did not expect any further changes before July 2019. The lack of inflationary pressures and the provision of monetary stimulus through expansion of the balance sheet (with the accumulation of purchases exceeding the country's GDP in December) could result in the decision to make no further changes lasting for the whole of 2019.

The yen has been losing ground against the dollar in a continuing gradual slide since March. Due to the rate differential with the United States, the yen may continue to depreciate slowly in 2019 down to a level of 105-110 JPY/USD.

1.2.8 Turkey

Reversal of the cycle and possibilities for economic reactivation

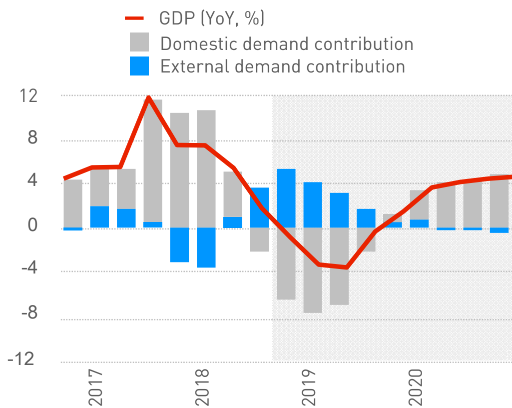
During 2018 economic activity in Turkey slowed down, falling from a peak of 11.6% YoY in the third quarter of 2017 to 1.6% in the third quarter of 2018. Over the same period, domestic demand registered a contraction of 2.2% YoY, while private investment and imports followed suit but with levels of 6.5% YoY and 8.1% YoY, respectively.

The first half of the year witnessed a financial storm that affected the performance of the Turkish lira in global financial markets. Nevertheless, the changes of economic policy announced by the Turkish government and the reduction of global tensions with the United States have enabled Turkish financial assets to stabilize in the second part of the year. Firstly, the macroeconomic strategies and goals presented in the government's new economic policy have been positively perceived by the market. Secondly, the tension with Washington has decreased after the positive gesture made by the Turkish legal authorities in freeing

Turkey

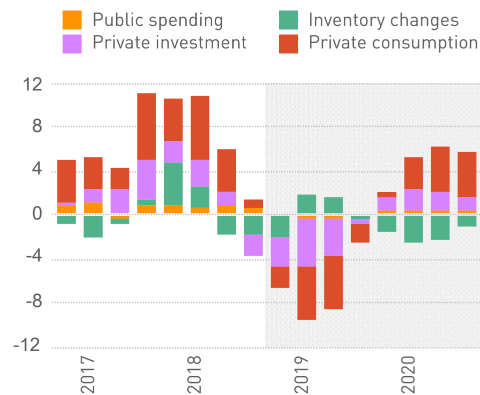
- The weak performance of the Turkish lira in the first half of 2018 made the ground fertile for a recession.
- The government's economic program and the lowering of tensions with the United States facilitated a stabilization of Turkish financial assets.
- At some point in 2019 the lowest point in the cycle will be reached, and from then on the Turkish economy should return to a path of growth.

Chart 1.2.8-a
Turkey: GDP breakdown and forecasts



Source: MAPFRE Economic Research (based on TURKSTAT data)

Chart 1.2.8-b
Turkey: domestic demand breakdown and forecasts



Source: MAPFRE Economic Research (based on TURKSTAT data)

Table 1.2.8
Turkey: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	5.3	6.0	3.3	7.4	3.2	-1.7	4.0
Domestic demand contribution	3.4	5.5	4.6	7.1	1.6	-4.0	4.0
External demand contribution	1.9	0.5	-1.3	0.3	1.6	2.3	-0.0
Private consumption contribution	1.9	3.4	2.2	3.7	2.1	-2.7	3.7
Private investment contribution	1.3	2.7	0.7	2.3	-0.3	-1.8	1.5
Contribution made by public spending	0.4	0.5	1.3	0.7	0.6	0.0	0.4
Domestic demand (% YoY, average)	3.2	5.4	4.5	7.0	1.6	-3.9	4.1
Total consumption (% YoY, average)	3.0	5.1	4.7	5.9	3.7	-3.5	5.6
Private investment (% YoY, average)	5.5	9.1	2.4	7.7	-1.0	-5.9	5.4
Exports (YoY in %)	8.3	4.3	-1.7	12.0	5.3	8.6	4.4
Imports (YoY in %)	-0.3	1.8	3.7	10.2	-1.9	-1.4	5.0
Unemployment rate (%, last quarter)	10.7	10.5	12.1	10.3	11.9	13.3	12.2
Inflation (% YoY, last quarter)	8.8	8.2	7.6	12.3	22.8	15.3	11.1
Fiscal balance (% of GDP)	-1.1	-1.1	-1.3	-1.6	-2.1	-2.0	-1.9
Trade balance (% of GDP)	-6.8	-5.6	-4.7	-6.9	-6.5	-3.7	-2.9
Fiscal stimulus (% GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-4.7	-3.7	-3.8	-5.6	-4.8	-1.4	-0.5
Official interest rate (end of period)	8.51	8.81	8.31	12.75	24.00	21.00	17.50
Short-term rate (end of period)	9.79	11.47	9.90	14.61	24.60	22.97	18.19
Long-term rate (end of period)	7.96	10.74	11.40	11.72	16.88	16.22	15.35
Exchange rate vs. USD (end of period)	2.33	2.92	3.52	3.79	5.47	5.52	5.47
Exchange rate vs. euro (end of period)	2.83	3.18	3.71	4.55	6.20	6.49	6.56
Private lending (% YoY, average)	23.2	23.0	12.8	20.6	18.4	8.4	9.8
Household lending (% YoY, average)	16.3	12.5	7.1	17.5	10.5	8.2	16.8
P.S. non-financial lending (% YoY, average)	30.1	29.9	14.7	24.3	21.8	1.6	19.1
P.S. financial lending (% YoY, average)	22.4	26.4	9.0	27.2	28.0	9.0	17.0
Savings rate (%, average)	26.2	28.3	32.8	31.0	30.1	29.1	24.9

Source: MAPFRE Economic Research (based on data of the TURKSTAT)
Forecast end date: January 8, 2019

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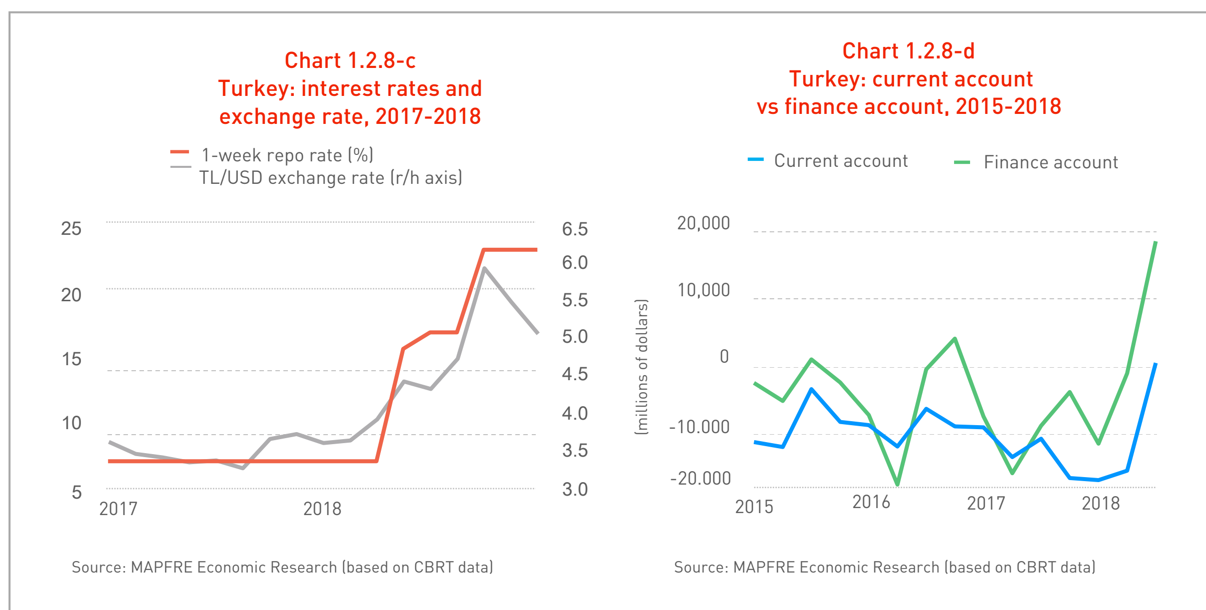

the American pastor Andrew Brunson. The factors mentioned above have resulted in an environment of greater confidence and less uncertainty that has manifested itself through the good performance of Turkish assets in the last part of the year. For its part, the USD-TRY exchange rate has readjusted from 6.9 in August to levels of between 5.0 and 5.5 in the last part of the year. At the same time, long-term bond yields have registered a compression of 500 basis points in the last two months.

Nevertheless, the physical commercial sector continues to show signs of slowdown, with the main indicators of activity registering contractions in November. Industrial production (-6.5% YoY), the sale of automobiles (-42,7%), the manufacturing PMI (44.7) and indicators of confidence (59.6 compared with an average of 69 for the last five years) accumulate patterns of behavior that clearly point to a slowdown. In the same way, the labor market has weakened and the unemployment rate stood at 11.6% at the end of October 2018, compared with 9.6% in April.

With regard to prices, inflation shot up to 25.4% YoY in October. The increase in prices was mainly explained by the pass-through effect of the exchange rate and inflationary trends in food prices. Nevertheless, the figure for November (21.6% YoY) suggests that the October figure represented a peak value and that prices should now follow a downward trajectory, unless oil prices register atypical increases. Overall, and taking basic effects into account, our forecasts show that inflation should stay at high levels until the second half of 2019.

All these elements constitute a scenario in which 2018 is expected to witness average growth of 3.2% YoY, closing the fourth quarter with a level of -1.1% YoY. However, in the first half of 2019, Turkey should reach the bottom point of the cycle and subsequently return progressively to a path of growth that is more consistent with the country's potential. All in all, 2019 could register average growth of -1.7% (see Charts 1.2.8-a and 1.2.8-b, and Table 1.2.8).

Faced with tension in terms of exchange rates and the more restrictive monetary policy assumed by the central bank, margins of maneuver have been ostensibly reduced, which is why there is little room for a fall in interest rates (Charts 1.2.8-c). Thus, if new risks were perceived to affect the Turkish lira, it is highly likely that the central bank will be obliged to implement new rate hikes. Nevertheless, our basic scenario assumes that this will not be the case, and that the official interest rate should slowly move toward levels below 20%.

1.2.9 Mexico

Growth forecasts below potential prevail

For 2018, it was predicted that the Mexican economy would keep growing at a rate of 2% and that this trend would continue in 2019. This result is mainly due to an improvement in the performance of the external sector (particularly as a result of an increase in trade with the United States due to the recent approval of the USMCA). It is also estimated that the unemployment rate will remain very low (3.2%) with forecasts that in 2019 inflation will be 4%, down on the previous year (4.6%) and that core inflation will stand at 3.6%. Thus, actual inflation would be close to the central bank's 3% objective (see Charts 1.2.9-a and 1.2.9-b, and Table 1.2.9).

However, despite the fact that the macroeconomic indicators appear to suggest an improvement in the economic dynamic (Chart 1.2.9-c), recent events in the political arena have awakened uncertainty in the financial markets. In December last year, Andrés Manuel López Obrador took office as the country's new president. Following his inauguration, the new government took a crucial decision regarding the new airport in Mexico City, putting the decision on its construction out to public consultation. The project's suspension, valued at 1% of GDP, has generated unease among investors. However, President López Obrador has indicated that the public consultation procedure may be used in new projects in the future, specifically to include issues related to the budget, which would open the door to amending or taking a step back in major structural reforms such as those related to energy. In addition, there is increased uncertainty regarding the investment contribution to total GDP, which is predicted to increase by 2% in 2019, similar to the level recorded in 2018.

Mexico

- **The cancellation of the Mexico City airport project and the decision to use the public consultation procedure for future projects was not well received by the markets.**
- **Uncertainty is increasing about the contribution of investment to growth.**
- **Consequently, growth estimates are being lowered to 2% for 2019 and 2020.**

As for monetary policy, the official interest rate was increased four times in 2018, in February, June, November and December, for a combined increase of 75 basis points up to 8.25%. Besides this, it is expected that interest rates will remain constant at around 8% with a view to 2019. The purpose of these increases was to reduce the volatility of the exchange rate and to control inflation, phenomena which also responded to the higher interest rates in the United States, the uncertainty surrounding the renegotiation of the USMCA, the cancellation of the construction of the new Mexico City airport and the tensions regarding trade policy.

For their part, the sovereign risk premium and medium and long-term interest rates have increased since the summer (the 10-year bond rose from 8.0% to 9.0%), reflecting investors' greater risk perception (Chart 1.2.9-d). Thus, the Mexican peso has depreciated from the level of 19.0 MXN/USD, where a balance appeared to have been struck, to a level of 19.6-20 MXN/USD at the close of 2018. However, it is expected that this trend will reverse in 2019, to reach new levels close to 19.0 MXN/USD.

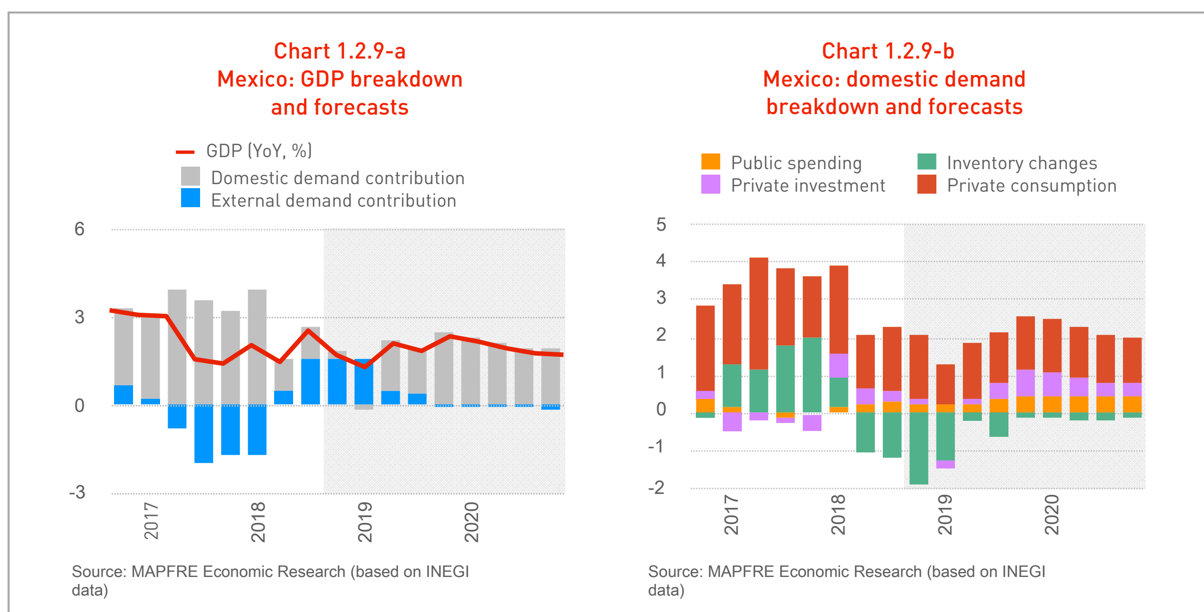

Table 1.2.9
Mexico: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	2.8	3.3	2.7	2.3	2.0	2.0	2.0
Domestic demand contribution	2.0	2.5	2.3	3.4	1.6	1.4	2.1
External demand contribution	0.8	0.8	0.4	-1.1	0.5	0.6	-0.1
Private consumption contribution	1.4	1.8	2.3	2.2	1.8	1.4	1.3
Private investment contribution	0.3	1.1	0.2	-0.3	0.4	0.3	0.5
Contribution made by public spending	0.3	0.2	0.3	0.0	0.2	0.3	0.4
Domestic demand (% YoY, average)	2.5	2.5	2.3	3.4	1.6	1.4	2.1
Total consumption (% YoY, average)	2.2	2.6	3.3	2.8	2.6	2.1	2.2
Private investment (% YoY, average)	3.0	5.1	1.1	-1.5	1.8	1.3	2.4
Exports (YoY in %)	6.9	8.6	3.5	3.9	7.5	3.9	1.8
Imports (YoY in %)	5.9	6.0	2.4	7.0	6.0	2.2	2.1
Unemployment rate (%, last quarter)	4.4	4.2	3.5	3.3	3.5	3.7	3.9
Inflation (% YoY, last quarter)	4.2	2.3	3.2	6.6	4.8	4.0	3.5
Fiscal balance (% of GDP)	-3.1	-3.4	-2.5	-1.1	-2.3	-2.8	-3.2
Trade balance (% of GDP)	-0.2	-1.2	-1.2	-0.9	-1.2	-1.5	-1.4
Fiscal stimulus (% GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-1.9	-2.6	-2.2	-1.6	-1.7	-1.6	-1.6
Official interest rate (end of period)	3.00	3.25	5.75	7.25	8.25	8.00	7.25
Short-term rate (end of period)	2.92	3.29	5.87	7.31	8.27	8.14	7.21
Long-term rate (end of period)	5.79	6.28	7.42	7.66	8.52	8.17	7.10
Exchange rate vs. USD (end of period)	14.75	17.20	20.74	19.67	20.08	19.41	19.07
Exchange rate vs. euro (end of period)	17.90	18.73	21.86	23.59	22.79	22.83	22.89
Private lending (% YoY, average)	10.8	13.6	16.3	12.1	10.6	3.7	5.9
Household lending (% YoY, average)	8.1	8.4	12.8	10.0	8.4	4.5	4.3
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	9.8	-11.4	3.5	1.7	-1.4	15.5	16.0
Savings rate (%, average)	13.8	14.6	12.8	10.8	11.4	9.5	9.5

Source: MAPFRE Economic Research (based on data of the INEGI)
Forecast end date: January 8, 2019

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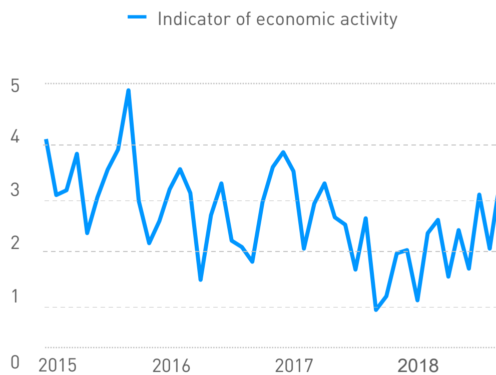
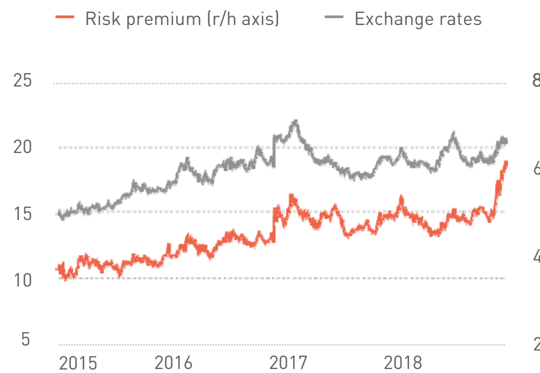
Chart 1.2.9-c
Mexico: index of economic activity, 2015-2018



Source: MAPFRE Economic Research (based on INEGI data)

Chart 1.2.9-d Mexico: exchange rate vs risk premium, 2015-2018



Source: MAPFRE Economic Research (based on Bank of Mexico data)

1.2.10 Brazil

Need for reform against the backdrop of a new government

In the third quarter of 2018 economic activity in Brazil recovered (1.3% YoY) driven by domestic demand, allowing for the prediction that it will close the year with a 1.2% increase. It is estimated that in 2019 economic activity should accelerate to 2.3%, thanks to private consumption, investment and exports. Total consumption will increase by 1.7%, investment by 3.7% and export activity benefiting from a depreciated currency will grow by 6.7%, while imports will tend to slow down (see Charts 1.2.10-a and 1.2.10-b, and Table 1.2.10). Meanwhile, the current account deficit increased to 0.9% in 2018, although it remains narrow compared with the 2010-2016 period. In this sense, a trajectory is predicted in which its external vulnerability will continue to reduce and the current account deficit will reach 0.5% in 2019.

Thanks to inflation in the region of 4% and interest rates in the United States (which everything suggests will bring about a pause in the pace of monetary normalization), the official interest rates in Brazil should be no higher than 7% at the end of 2019 and 8% at the end of 2020. This, combined with a gradual recovery of the labor market, will allow for

Brazil

- A global outlook of slowdown with an ongoing process of monetary hardening will have repercussions on Brazil's monetary policy and on its pace of growth.
- Jair Bolsonaro was elected as Brazil's president, and although he was well received by the markets, the implementation of reforms will remain a complex process.
- Tax and social security (pensions) reforms are urgently needed to preserve the country's credit profile.

growth in the region of 2.6% with a view to 2020. However, the political agenda will see the need to push through reforms (in particular that for pensions), but also to make progress on the agenda for privatizations and reforms to stimulate economic activity. If a social security reform is approved, it will only start to produce results from 2020 and gross debt will continue to increase next year to reach 78.8% of GDP (Chart 1.2.10-d).

Moreover, the continuous hardening of the monetary conditions in various countries and the intensifying trade tensions, affect the emerging markets in general. However, the expected pause in the hardening of the

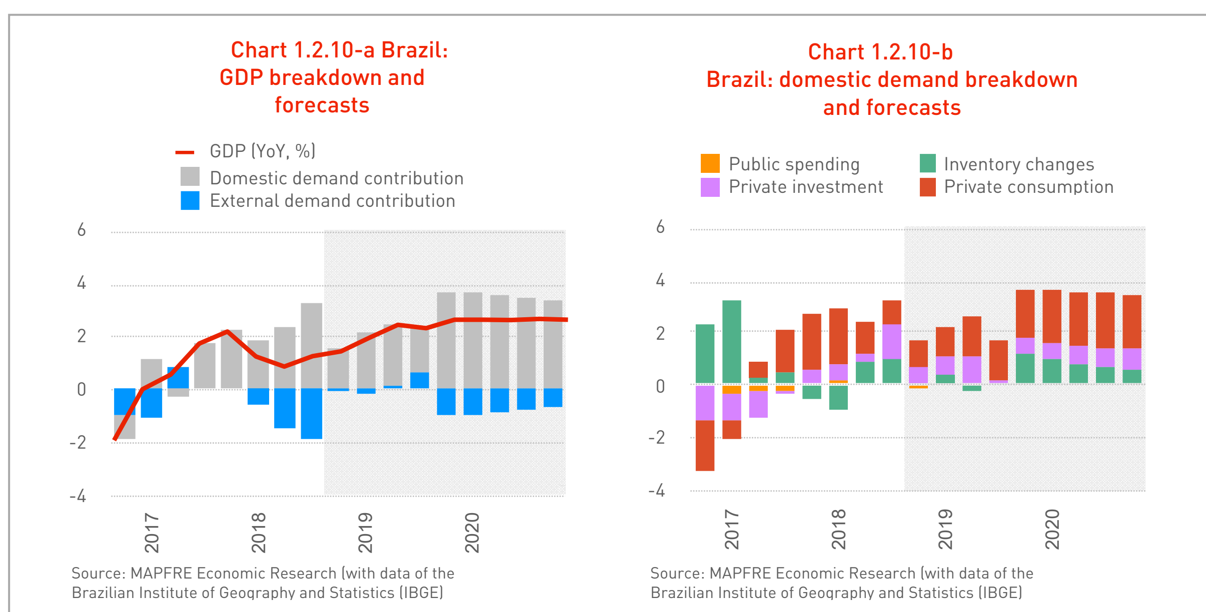


Chart 1.2.10-a Brazil: GDP breakdown and forecasts

Source: MAPFRE Economic Research (with data of the Brazilian Institute of Geography and Statistics (IBGE)

Chart 1.2.10-b Brazil: domestic demand breakdown and forecasts

Source: MAPFRE Economic Research (with data of the Brazilian Institute of Geography and Statistics (IBGE)

Table 1.2.10
Brazil: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	0.5	-3.6	-3.3	1.1	1.2	2.3	2.6
Domestic demand contribution	0.5	-7.1	-5.1	1.2	2.2	2.4	3.5
External demand contribution	0.0	3.6	1.8	-0.1	-1.0	-0.1	-0.8
Private consumption contribution	1.5	-2.2	-2.7	0.9	1.3	1.5	2.0
Private investment contribution	-0.8	-2.9	-2.3	-0.4	0.7	0.6	0.7
Contribution made by public spending	0.1	-0.2	0.0	-0.2	0.0	-0.0	0.0
Domestic demand (% YoY, average)	0.2	-6.7	-4.9	1.2	2.2	2.4	3.4
Total consumption (% YoY, average)	2.0	-2.8	-3.0	0.9	1.5	1.7	2.3
Private investment (% YoY, average)	-4.1	-14.0	-12.0	-2.4	4.4	3.7	4.0
Exports (YoY in %)	-1.3	6.8	0.7	5.8	2.7	6.7	3.6
Imports (YoY in %)	-2.3	-14.1	-9.6	5.6	8.6	6.2	7.6
Unemployment rate (%, last quarter)	6.5	9.0	12.0	11.8	12.0	10.4	9.4
Inflation (% YoY, last quarter)	6.5	10.4	7.0	2.8	4.1	4.1	4.0
Fiscal balance (% of GDP)	-6.0	-10.2	-9.0	-7.8	-8.1	-7.0	-6.3
Trade balance (% of GDP)	-0.3	1.0	2.5	3.1	2.8	2.7	2.2
Fiscal stimulus (% GDP)	-0.5	-1.8	-2.4	-1.7	-2.2	-1.8	-1.2
Current account balance (% of GDP)	-4.1	-3.0	-1.3	-0.3	-0.9	-0.5	-0.9
Official interest rate (end of period)	11.32	14.25	13.97	7.58	6.50	7.00	8.00
Short-term rate (end of period)	11.65	14.15	13.65	6.90	6.44	6.85	7.87
Long-term rate (end of period)	12.25	16.10	11.36	10.24	9.89	9.89	9.41
Exchange rate vs. USD (end of period)	2.66	3.90	3.26	3.31	3.86	3.70	3.74
Exchange rate vs. euro (end of period)	3.22	4.25	3.43	3.97	4.38	4.35	4.49
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	14.0	9.9	4.3	4.6	6.6	12.0	13.9
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (%, average)	20.3	18.2	17.3	18.3	18.2	18.3	17.9

Source: MAPFRE Economic Research (based on data of the Brazilian Institute of Geography and Statistics, IBGE)
Forecast end date: January 8, 2019

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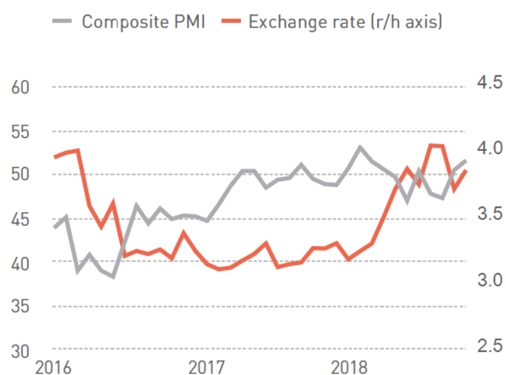
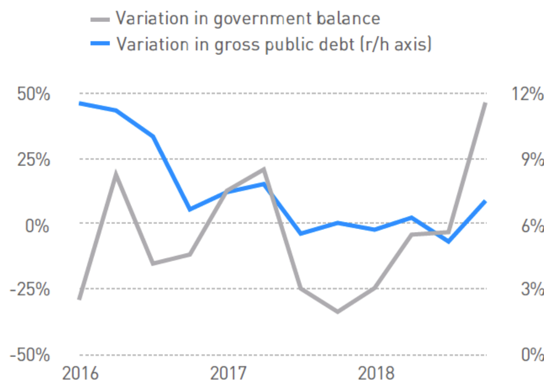
Chart 1.2.10-c
Brazil: Composite PMI
vs exchange rate, 2016-2018



Source: MAPFRE Economic Research (based on Central Bank of Brazil and IHS Markit data)

Chart 1.2.10-d
Brazil: government balance
vs gross public debt, 2016-2018



Source: MAPFRE Economic Research (based on Central Bank of Brazil and Haver Analytics data)

monetary policy in the United States causes us to predict stability of the real in the region of 3.70 by the end of 2019.

1.2.11 Argentina

Economy in recession

The Argentinian economy has officially entered a period of recession, registering for a third quarter a contraction of 3.5% compared with the same period the previous year. The combination of various phenomena during 2018 has severely affected the economic performance of Latin America's third largest economy.

In 2018, the recessive effects of the currency crisis have been evident. Inflation has shot up from 27.1% in the second quarter to 35.4% in the third quarter (Chart 1.2.11-d), having a negative impact on household income, consumption and actors' confidence. In this environment, the Argentinian government and the International Monetary Fund (IMF) signed an agreement in an attempt to stabilize the economy. The Stand By program totaling 57,100 million dollars for a period of 36 months sought to restore confidence on two fronts: (i) tackle the fiscal imbalances, and (ii) strengthen the Central Bank of the Argentine Republic which will now have the objective of containing inflation and implementing a floating exchange rate policy without intervention.

However, the positive effects of this agreement are a long way off.

Despite the fact that in the real sector the effects of the agreement between the government and the IMF are yet to be felt at all, the financial markets have welcomed the agreement. Thus, since October the Argentine peso has stabilized to a range of between 35 and 38 ARS–USD. For its part, the LELIQ (a new 7-year reference rate for Argentinian state bonds with daily quotation) liquidity bills rate has seen a downward trend from the peak of 73.5% in the second week of October to a level of 60% in December (Chart 1.2.11-c).

Thus, our average growth prediction for 2018 is in the region of -2.5%. In the fourth quarter of 2018, we expect it to close the year with a decrease of close to 6.0%. Now in 2019, we

Argentina

- **Argentina entered squarely into negative territory in 2018.**
- **The agreement between the Argentine government and the IMF had positive effects on the financial markets.**
- **At some point in 2019 the Argentine economy will reach the lowest point in the cycle.**

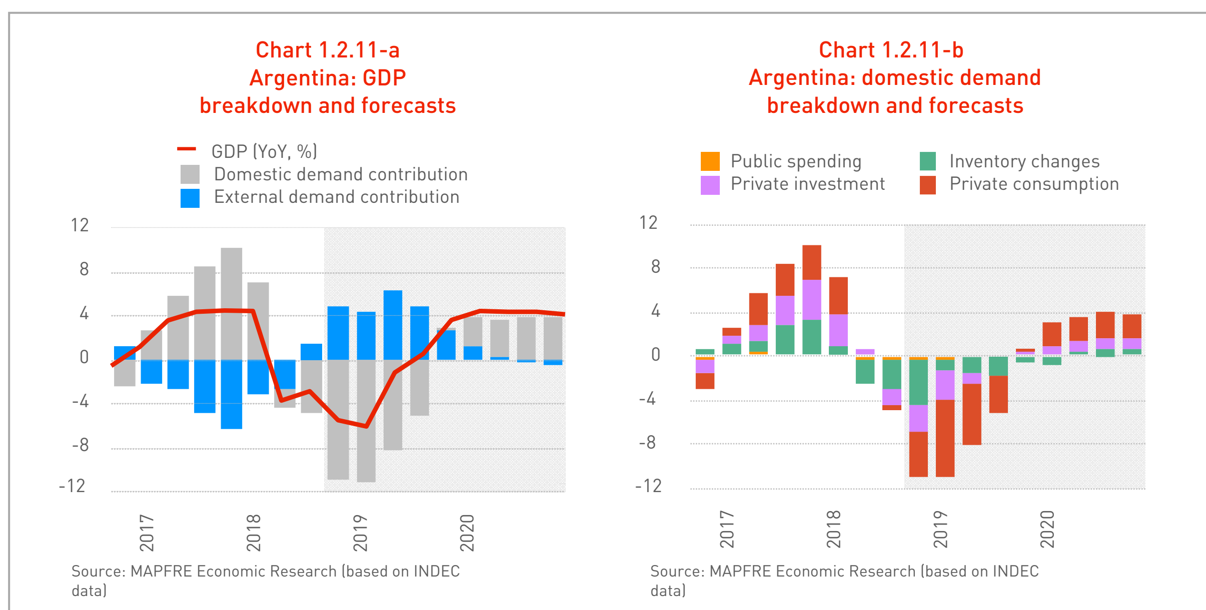


Chart 1.2.11-a
Argentina: GDP breakdown and forecasts

Source: MAPFRE Economic Research (based on INDEC data)

Chart 1.2.11-b
Argentina: domestic demand breakdown and forecasts

Source: MAPFRE Economic Research (based on INDEC data)

Table 1.2.11
Argentina: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	-2.5	2.7	-1.7	2.8	-2.5	-1.3	3.8
Domestic demand contribution	-4.0	4.0	-1.8	6.8	-2.6	-5.9	3.5
External demand contribution	1.5	-1.3	0.1	-4.0	0.1	4.6	0.3
Private consumption contribution	-3.1	2.5	-0.7	2.5	-0.2	-3.9	2.3
Private investment contribution	-1.2	0.7	-0.9	2.1	-0.1	-0.8	0.9
Contribution made by public spending	0.4	0.9	0.0	0.3	-0.2	-0.1	0.1
Domestic demand (% YoY, average)	-3.6	3.8	-1.7	6.4	-2.3	-5.4	3.3
Total consumption (% YoY, average)	-3.2	4.1	-0.8	3.3	-0.6	-4.5	2.8
Private investment (% YoY, average)	-6.6	3.4	-4.8	10.8	0.3	-4.0	4.4
Exports (YoY in %)	-6.2	-2.3	6.1	1.0	-0.3	7.6	5.5
Imports (YoY in %)	-9.7	3.6	4.4	15.9	-0.1	-10.3	3.5
Unemployment rate (%, last quarter)	6.9	7.0	7.6	7.2	7.6	8.2	7.8
Inflation (% YoY, last quarter)	44.2	26.0	39.3	23.3	47.5	26.6	19.5
Fiscal balance (% of GDP)	-4.8	-5.9	-5.8	-6.0	-4.9	-3.3	-3.3
Trade balance (% of GDP)	1.0	-0.1	0.8	-0.9	-0.8	2.7	2.9
Fiscal stimulus (% GDP)	-3.2	-3.9	-4.1	-3.7	-2.5	-0.2	0.6
Current account balance (% of GDP)	-1.6	-2.7	-2.7	-4.9	-5.6	-2.5	-2.5
Official interest rate (end of period)	25.33	33.00	24.75	28.75	63.00	54.50	46.50
Short-term rate (end of period)	16.00	26.00	26.75	30.75	62.98	41.93	26.93
Long-term rate (end of period)	9.36	6.65	7.00	5.91	10.07	9.17	8.94
Exchange rate vs. USD (end of period)	8.55	13.04	15.89	18.65	39.29	48.58	56.33
Exchange rate vs. euro (end of period)	10.38	14.20	16.75	22.37	44.59	57.13	67.60
Private lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (%, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Source: MAPFRE Economic Research (based on data of the INDEC)
Forecast end date: January 8, 2019

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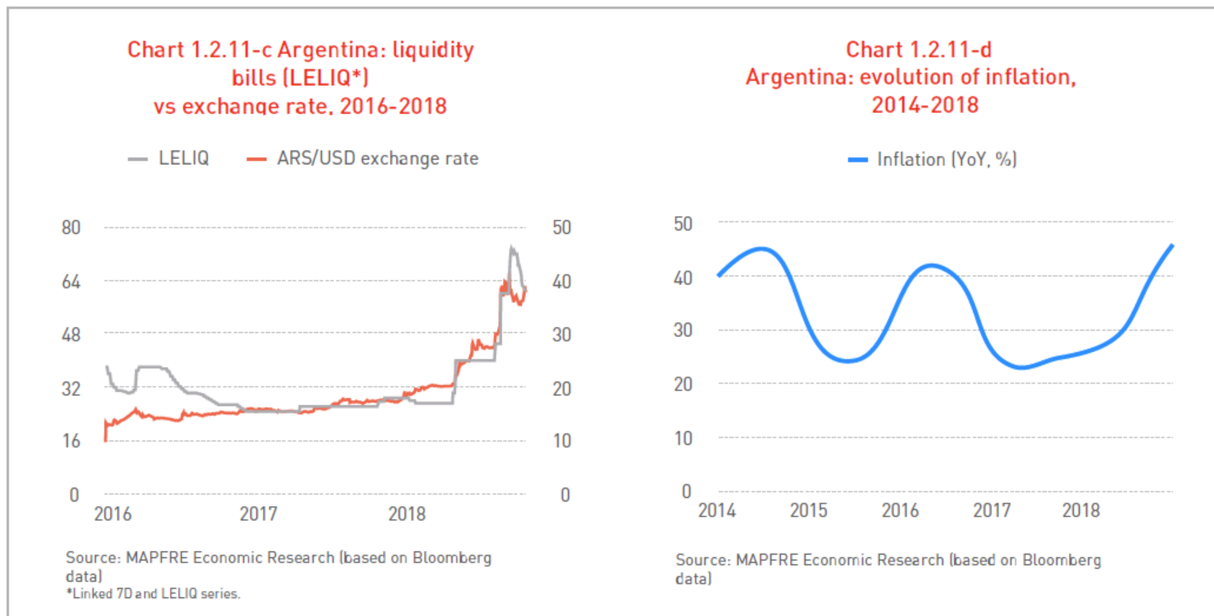

expect the lowest part of the cycle to be reached in the first quarter with a decrease of -6.6% YoY. This would set the Argentinian economy on a path of recovery allowing for average growth in 2019 of -1.3%. In other words, 1.2% higher than the 2018 forecast (see Charts 1.2.11-a and 1.2.11-b, and Table 1.2.11).

These elements will be accompanied by an inflation rate that will gradually climb back up to the levels of 20-30% by the close of 2019. If the expected effects of the agreement between the IMF and the Argentine government materialize, prices are likely to follow a downward trajectory which could cause them to fall below 20% YoY at any point in 2020. As for the labor market, the economic recession will result in lower levels of recruitment, driving up the unemployment rate to over 9.6% in the first quarter of 2019.

In conclusion, the Argentine economy has entered the lowest part of the cycle which could continue until the end of 2019. In the medium-term, the path of recovery will largely depend on the process of adjustment that accompanies the agreement signed between the government and the IMF.

1.2.12 China

Slower growth with continuing imbalances

The Chinese economy continues to show signs of slowdown: industrial production and retail sales slowed down more than anticipated, according to November figures, propelled by weaker external demand and slower discretionary consumption, while investment in infrastructures continued to be moderate. The earliest data available such as PMIs (Chart 1.2.12-c) show that, although activity will remain on the positive side of the growth spectrum, it is much less dynamic. The

China

- It is expected that the growth of the Chinese economy will slow to 6.2% in 2019, due to the loss of global economic dynamism and the effect of the trade war.
- China is facing lower growth with major imbalances, but its room for maneuver is greater than that of the developed economies.
- The government will implement monetary and fiscal stimulus policies that allow the target growth levels to be maintained. The financial stability objective could be temporarily relegated.

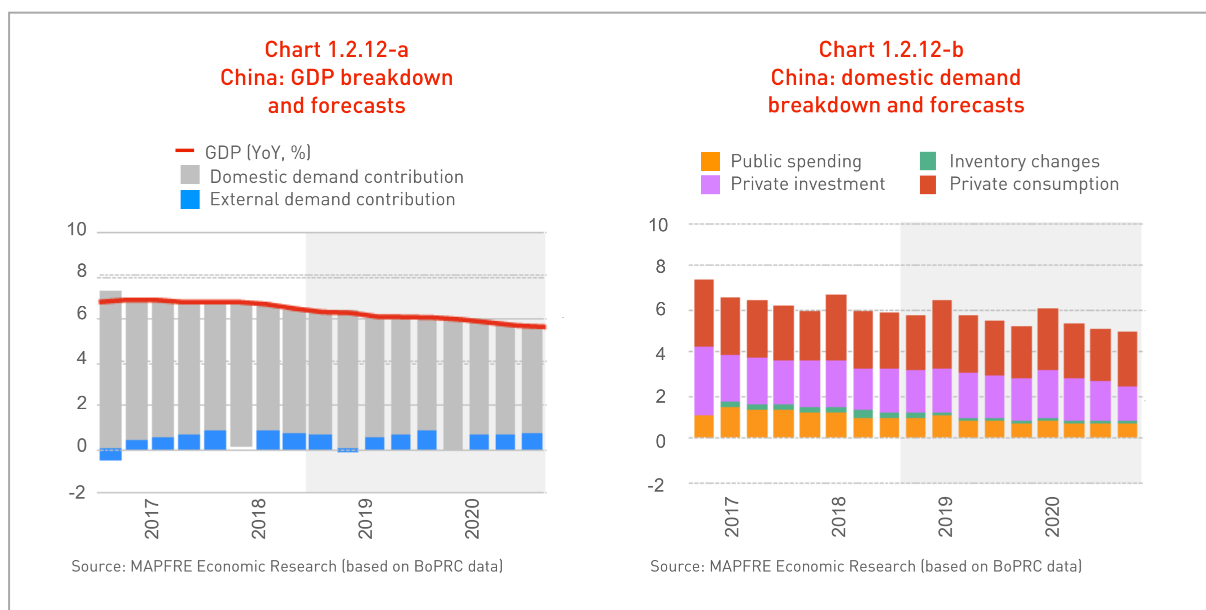

Chart 1.2.12-a
China: GDP breakdown and forecasts

Source: MAPFRE Economic Research (based on BoPRC data)

Chart 1.2.12-b
China: domestic demand breakdown and forecasts

Source: MAPFRE Economic Research (based on BoPRC data)

Table 1.2.12
China: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	7.3	6.9	6.7	6.9	6.6	6.2	5.8
Domestic demand contribution	5.7	6.9	7.3	6.2	6.0	5.7	5.3
External demand contribution	1.6	-0.0	-0.6	0.6	0.6	0.5	0.5
Private consumption contribution	3.1	3.1	3.1	2.6	2.7	2.7	2.6
Private investment contribution	2.2	3.4	3.1	2.1	2.0	2.0	1.9
Contribution made by public spending	0.4	0.9	1.2	1.3	1.0	0.9	0.8
Domestic demand (% YoY, average)	7.2	7.1	7.5	6.4	6.1	5.8	5.5
Total consumption (% YoY, average)	7.1	8.0	8.6	7.6	7.2	6.8	6.4
Private investment (% YoY, average)	6.9	7.4	6.7	4.6	4.5	4.6	4.4
Exports (YoY in %)	5.4	0.5	1.8	6.6	5.4	3.9	4.4
Imports (YoY in %)	7.7	0.6	3.2	8.2	8.8	5.2	5.4
Unemployment rate (%, last quarter)	4.1	4.1	4.0	3.9	3.9	3.9	3.9
Inflation (% YoY, last quarter)	1.5	1.5	2.2	1.8	2.4	2.1	2.6
Fiscal balance (% of GDP)	-1.8	-3.4	-3.8	-3.7	-3.8	-3.9	-3.9
Trade balance (% of GDP)	4.2	5.3	4.4	3.9	2.9	2.8	2.6
Fiscal stimulus (% GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	2.3	2.8	1.8	1.3	0.3	0.3	0.3
Official interest rate (end of period)	4.96	2.32	2.59	3.09	3.04	3.34	3.78
Short-term rate (end of period)	5.75	3.05	4.25	5.53	3.33	3.77	4.18
Long-term rate (end of period)	3.63	2.82	3.05	3.91	3.36	3.99	4.40
Exchange rate vs. USD (end of period)	6.20	6.49	6.94	6.51	6.91	6.71	6.46
Exchange rate vs. euro (end of period)	7.53	7.07	7.32	7.80	7.84	7.90	7.75
Private lending (% YoY, average)	13.4	14.8	13.3	10.5	12.2	10.4	8.7
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Savings rate (%, average)	39.7	39.3	38.4	38.6	38.2	38.0	37.5

Source: MAPFRE Economic Research (based on data of the BoPRC)
Forecasting end date: January 8, 2019

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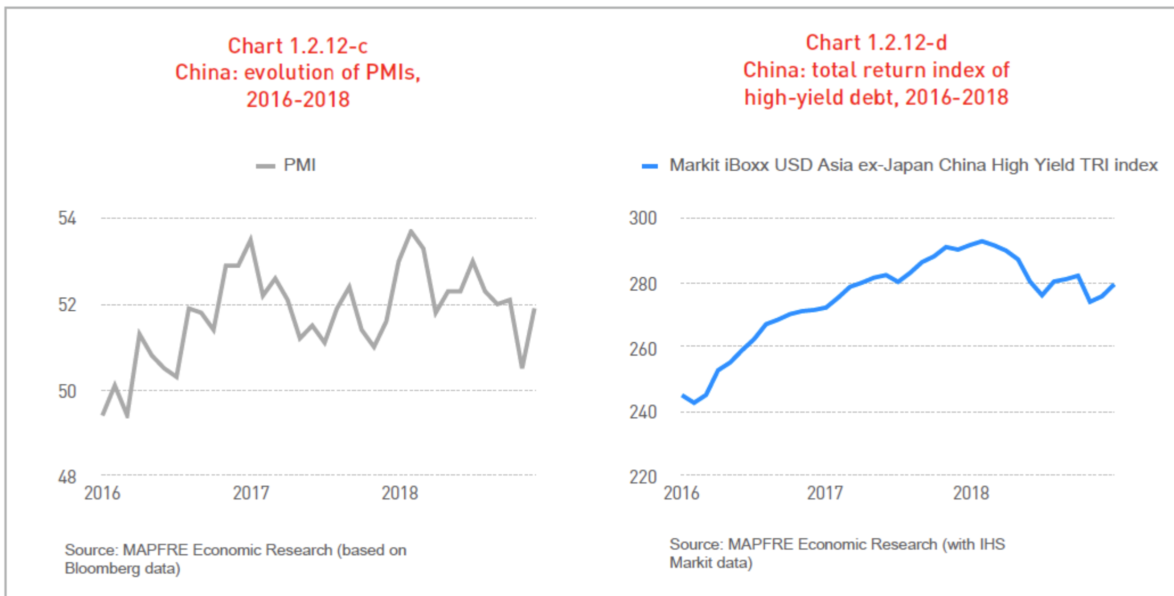


economic slowdown involves major challenges in terms of external demand, while at the same time domestic demand shows clear signs of fatigue (as is the case for the rest of the world). This means we are obliged to expect an average growth level for 2019/2020 slightly lower than 6%, the lowest registered since the 1990s (see Charts 1.2.12-a and 1.2.12-b, and Table 1.2.12).

This slowdown is attributable to three factors: (i) a lower level of external dynamism, especially in the United States and the eurozone, which are displaying the cyclical change already expected, as observed above; (ii) the effects of the tariff war, despite the three-month-old truce[17] (these effects are channeled toward investment expectations), and (iii) a blend of economic policies that has not worked as well as could have been hoped during the last year.

This blend of economic policies was characterized as an exercise with three objectives that are difficult to reconcile: (i) adjust domestic imbalances, especially ("balancing act"), especially in real estate and money markets, while also striving to (ii) inject new dynamism into economic activity, and all of the above (iii) without distorting or increasing corporate debt (the total return index of High Yield debt has increased almost 50 basis points in five years as a result of the credit deterioration of companies in which the state holds an interest). Thus, despite the fact that the objective was to boost activity without generating imbalances, its effect has been limited and credit has accelerated by an average of 2% (from 10% to 12%, approximately), resulting in steady growth in corporate leverage.

China is also facing a moment of change in the economic cycle leading to slower growth and greater vulnerabilities, but its capacity to face the risks would seem to be stronger than that of the rest of the world. For this reason, and with the incentive of the turn in cyclical momentum, it has been decided to confidently reactivate stimulus measures abandoning for the moment the commitment to financial stability made by President Xing Ping at the start of the year, which, for now, is being addressed with structural measures with long-term effects.

The economic reactivation formula provides for monetary stimuli focused specifically on small and medium-sized enterprises and on the end consumer, which complement the measures activated in 2018[18] such as the reduction in the ratio of reserves required from the financial sector, which implicitly releases almost 2.2 billion dollars in liquidity in the system and the lowering of the benchmark rate. The most visible effect of the reduction in both was the fall in the Repo to 2.2% (January 8), although it is gradually recovering to around 3%.

In fiscal terms, the planned stimulus is also significant and envisages a reduction in the tax

burden for both consumers (increase in tax-exempt income, mortgage deductions and spending on health and education), and for companies (reduction in the input VAT on certain industrial and transport categories). In the current context of weak growth and with a possible rate increase on the horizon, the central bank will maintain its stance of keeping the exchange rate in the current band.

1.2.13 Indonesia

Indonesia

- Stable economic growth rates and financial resilience.
- Elections in April 2019.
- With inflationary pressures under control, the central bank is focusing on external stability and the exchange rate.

Economic growth and financial resilience

The Indonesian economy grew at a stable rate of 5.2% in the third quarter of 2018, with predictions of a slightly lower rate at the close of the year (5.1%) and of these levels being maintained throughout 2019. This growth is mainly based on the drive in domestic demand, positive levels of investment and public spending which is expected to remain constant at least until the next parliamentary elections scheduled for April 2019 (see Charts 1.2.13-c and 1.2.13-d, and Table 1.2.13).

2018 has been marked by the hardening of external financial conditions, which has had a moderate impact on the Indonesian economy (Chart 1.2.13-b). In this sense, the government has responded with restrictive fiscal policies through the hardening of its fiscal framework and the containment of public spending delaying the implementation of certain planned infrastructure projects. At the same time, the imbalance in its current account remains negative at 2.4% (average for the year), mainly due to the high growth in imports of oil and raw materials.

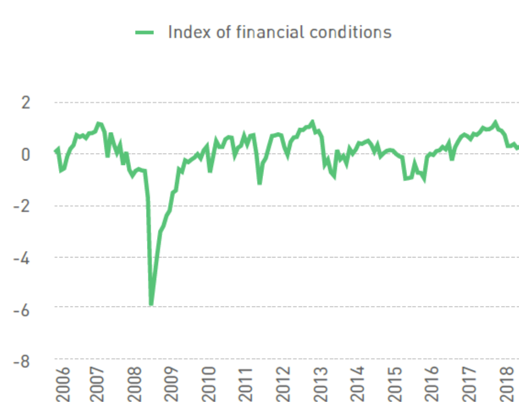
As for inflation, it should close 2018 at around 3.7% (3.2% in November). Although a slight increase in inflation is expected in 2019 as a result of the removal of certain subsidies, it should remain in the target range of 2.5-4.5%.

The macro-prudential policy continues to focus on macroeconomic stability. In the last meeting of the central bank, and following the increase of 175 basis points throughout the year, rates remained unchanged, to the extent that

Chart 1.2.13-a
Indonesia: exchange rate vs evolution of equities, 2014-2018

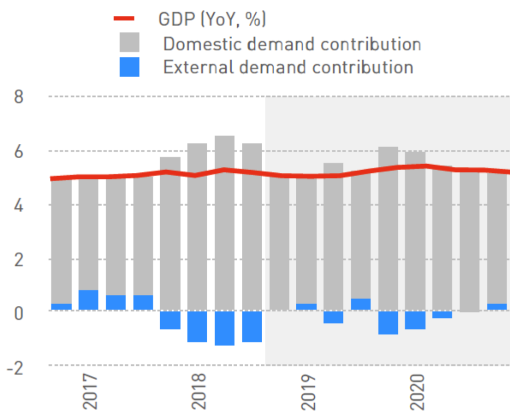
Source: MAPFRE Economic Research (based on Bloomberg data)

Chart 1.2.13-b
Indonesia: index of financial conditions, 2006-2018



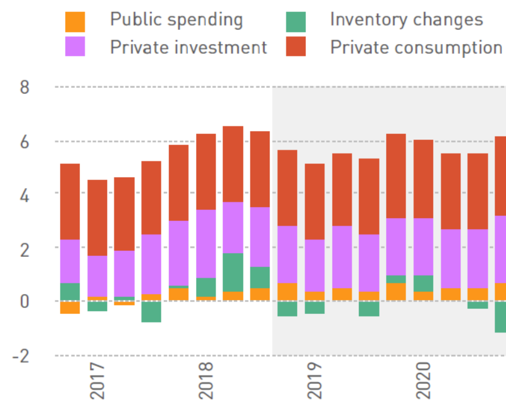
Source: MAPFRE Economic Research (based on Citi Indonesia Financial data)

Chart 1.2.13-c
Indonesia: GDP breakdown and forecasts



Source: MAPFRE Economic Research (based on Indonesian Central Bureau of Statistics data)

Chart 1.2.13-d
Indonesia: domestic demand breakdown and forecasts



Source: MAPFRE Economic Research (based on Indonesian Central Bureau of Statistics data)

Table 1.2.13
Indonesia: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	5.0	4.9	5.0	5.1	5.1	5.2	5.3
Domestic demand contribution	4.6	3.9	4.9	4.7	6.0	5.3	5.4
External demand contribution	0.4	0.9	0.2	0.4	-0.9	-0.1	-0.1
Private consumption contribution	2.9	2.7	2.8	2.8	2.8	2.9	2.9
Private investment contribution	1.0	1.6	1.5	2.0	2.2	2.1	2.3
Contribution made by public spending	0.1	0.5	-0.0	0.2	0.4	0.4	0.5
Domestic demand (% YoY, average)	5.3	4.0	4.9	4.8	6.1	5.3	5.4
Total consumption (% YoY, average)	4.7	4.9	4.4	4.6	5.1	5.3	5.2
Private investment (% YoY, average)	4.5	5.0	4.5	6.1	6.8	6.4	6.9
Exports (YoY in %)	1.3	-2.1	-1.6	9.2	6.6	4.3	5.5
Imports (YoY in %)	2.2	-6.2	-2.5	8.1	11.8	5.1	6.3
Unemployment rate (%, last quarter)	5.9	5.8	5.5	5.3	5.3	4.8	4.4
Inflation (% YoY, last quarter)	6.5	4.8	3.3	3.5	3.7	3.7	3.5
Fiscal balance (% of GDP)	-2.2	-2.6	-2.5	-2.6	-2.2	-2.0	-2.0
Trade balance (% of GDP)	0.8	1.6	1.6	1.9	0.4	1.3	1.6
Fiscal stimulus (% GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	-3.1	-2.0	-1.8	-1.7	-2.5	-2.2	-1.6
Official interest rate (end of period)	6.50	6.25	4.75	4.25	6.00	6.50	6.50
Short-term rate (end of period)	7.17	8.86	7.46	5.48	7.67	7.66	7.71
Long-term rate (end of period)	7.86	8.81	7.85	6.30	8.01	8.71	8.83
Exchange rate vs. USD (end of period)	12,427	13,836	13,525	13,484	14,534	14,272	14,058
Exchange rate vs. euro (end of period)	15,088	15,063	14,257	16,171	16,496	16,783	16,870
Private lending (% YoY, average)	15.2	10.6	7.8	8.2	10.3	8.8	9.8
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	4.4	32.0	10.1	15.1	4.3	3.3	9.3
Savings rate (%, average)	17.0	17.0	17.0	17.0	17.3	17.9	18.1

Source: MAPFRE Economic Research (based on data of the BPS)
Forecast end date: January 8, 2019

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inflation was controlled and within the target set by the regulator. However, this does not prevent the central bank from continuing to increase interest rates, given the objective of maintaining external stability and containing currency evolution (Chart 1.2.13-a). In this sense, it is predicted that in 2019 the monetary stance of the central bank may harden, increasing the official rates by 100 basis points, in line with the movements that ultimately occur in the United States monetary policy.

With a view to 2019, the focus will be on the Indonesian presidential and parliamentary elections which will be held on April 17, following which the new president will take office on October 20. The topics on the economic agenda will relate mainly to the liberalization of energy prices and equilibrium in its external balance.

1.2.14 Philippines

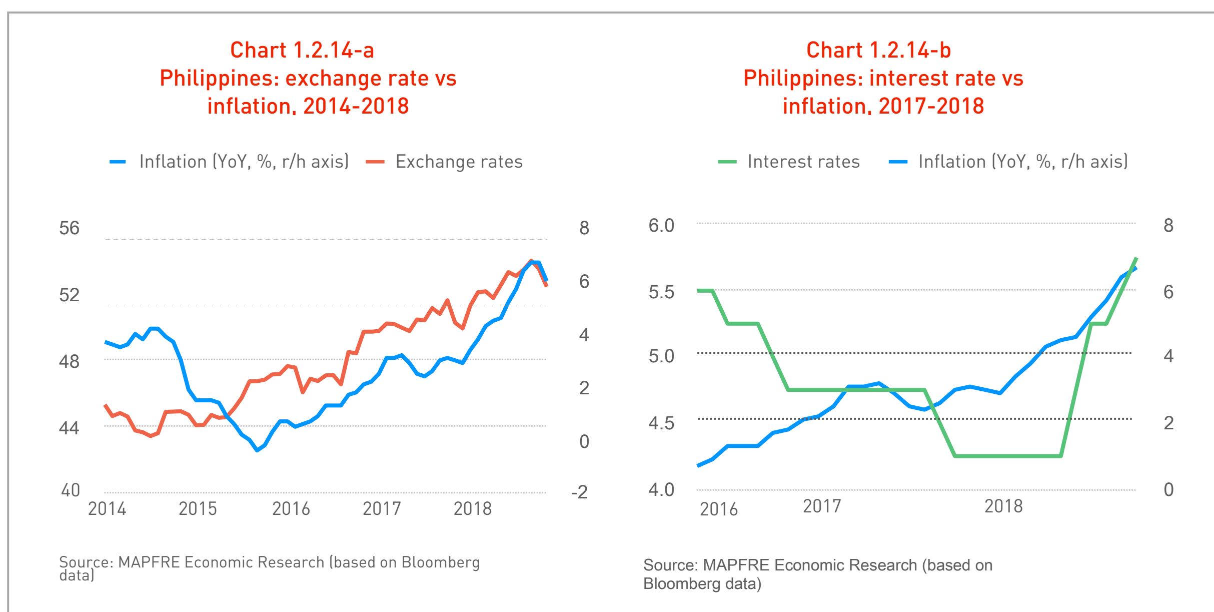
Dynamic growth with an increase in external imbalances

The Philippine economy is maintaining strong growth (6.1% in the third quarter of 2018), which should finish the year at 6.3% thanks to sustained internal demand (private, +5.2%; public, +14.3%), but also investment (+16.7%) and exports (+14.3%). Against the backdrop of a global slowdown, a slight decrease in GDP growth to 6.2% is expected in 2019, below the government's objective of 6.5% (see Charts 1.2.14-c and 1.2.14-d, and Table 1.2.14). Looking to the future, it can be expected that investment will remain strong and more modest inflation (with peaks registered in October 2018) should help to maintain the pace of growth of private consumption.

Philippines

- Vigorous growth in 2018 driven by domestic demand and investment.
- External imbalance is increasing due to a high trade deficit.
- The inflation rate is slackening after peaking in October.

The trade deficit increased considerably in October with imports up by 21.4%, mainly due to oil and other raw materials and capital goods, while exports only increased 3.3% hampered mainly by the agricultural products affected by adverse weather events. In this sense, the latest data reflect a strong internal market and weakening external demand, although the expectations surveys saw an



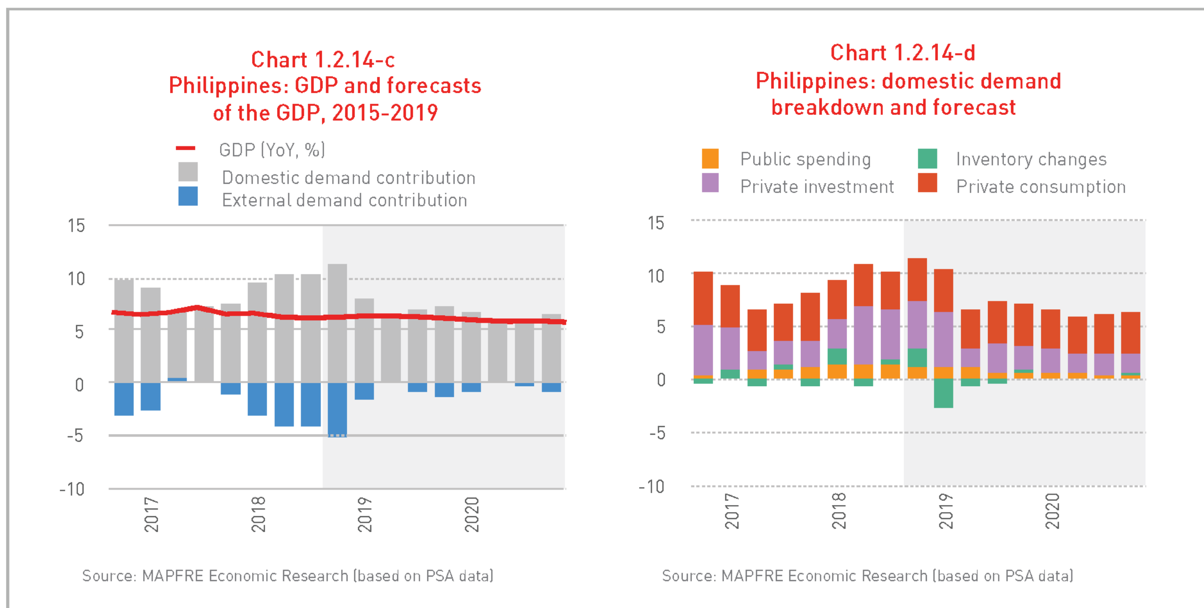


Table 1.2.14
Philippines: main macroeconomic aggregates

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY, average)	6.1	6.0	6.9	6.7	6.3	6.2	5.8
Domestic demand contribution	4.8	9.1	11.9	7.5	10.4	7.1	6.3
External demand contribution	1.3	-3.0	-5.0	-0.8	-4.1	-0.9	-0.5
Private consumption contribution	3.9	4.4	4.9	4.1	3.8	4.1	3.8
Private investment contribution	1.1	3.6	6.2	2.7	4.4	2.9	1.9
Contribution made by public spending	0.3	0.8	0.9	0.7	1.4	0.9	0.4
Domestic demand (% YoY, average)	5.0	9.0	11.5	6.9	9.6	6.3	5.6
Total consumption (% YoY, average)	5.2	6.5	7.4	6.0	6.5	6.3	5.3
Private investment (% YoY, average)	7.2	16.6	26.6	9.5	15.5	9.3	5.9
Exports (YoY in %)	12.6	8.7	11.7	19.6	10.6	10.4	6.1
Imports (YoY in %)	10.1	14.6	20.5	18.2	15.7	9.9	5.7
Unemployment rate (%, last quarter)	6.0	5.6	4.7	5.0	5.1	4.7	4.4
Inflation (% YoY, last quarter)	2.9	0.3	2.0	3.0	6.0	3.4	4.0
Fiscal balance (% of GDP)	-0.6	-0.9	-2.4	-2.2	-3.0	-3.0	-2.9
Trade balance (% of GDP)	-6.1	-8.0	-11.7	-12.9	-14.8	-14.7	-14.2
Fiscal stimulus (% GDP)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current account balance (% of GDP)	3.8	2.5	-0.4	-0.7	-2.3	-2.5	-2.3
Official interest rate (end of period)	4.00	4.00	3.00	3.00	4.75	5.25	5.50
Short-term rate (end of period)	3.09	3.03	2.50	3.22	5.00	5.54	5.57
Long-term rate (end of period)	4.37	4.10	4.63	5.70	7.33	7.71	7.71
Exchange rate vs. USD (end of period)	44.62	47.17	49.81	49.92	53.02	51.93	50.79
Exchange rate vs. euro (end of period)	54.17	51.35	52.51	59.87	60.18	61.07	60.95
Private lending (% YoY, average)	18.0	13.2	15.3	18.0	16.1	10.3	9.9
Household lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. non-financial lending (% YoY, average)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
P.S. financial lending (% YoY, average)	8.8	2.6	8.7	9.2	10.2	10.4	9.9
Savings rate (%, average)	9.3	7.7	7.8	8.1	7.5	7.3	7.2

Source: MAPFRE Economic Research (based on PSA data)
Forecast end date: January 8, 2019

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improvement in the latest data from November.

Meanwhile, inflation fell back to 5.2% in December from the previous 6% (Chart 1.2.14-a) thanks to reduced pressure on food and fuel. In this regard, it is predicted that inflation will probably stabilize at around 4.% in the first half of 2019, still above the central bank's target range (2-4%).

In terms of monetary policy, at its December meeting the central bank kept interest rates at 4.75% (Chart 1.2.14-b), following the hardening of 175 basis points throughout 2018, motivated by the decrease in inflationary pressures registered in the last few months of the year. The interest rate increases in 2018 were reflected in the interest rates applied by commercial banks and a slowdown in credit growth was observed from levels of 20% in 2017 to 10% at the end of 2018. Despite more contained inflation data, with a view to 2019 it is estimated that the Philippine central bank will increase rates by a further 25 basis points in the first quarter of the year, while the following decisions will be contingent upon the performance of inflation and the credit boost.

2. Industry outlook

2.1 The economic environment and its impact on insurance demand

2.1.1 Global markets

The current economic situation foresees a world growth rate for 2019 of around 3.3% (3.6% in 2018, according to the latest data available), which would confirm a trend toward a moderate slowdown in global demand, within the context of increased financial costs, caused to a great extent by the monetary normalization policy in the US. The forecast global growth is still significant, but its level and synchronization continue to drop, confirming the symptoms that announce a change in economic cycle.

For the moment, the economic activity growth favors the development of the insurance market, to a greater extent in emerging markets, where the still low penetration rate of insurance generally implies increased elasticity in premium growth as GDP increases, as well as offering considerable growth potential for the future (see Box 2.1.1). However, circumstantially, the slowdown of the global economic activity will affect the growth of world insurance premiums, especially in the Non-Life and Life risk segments, given their strong link with the behavior of the economic cycle. Although the normalization of monetary policies may help the development of the Life savings and annuities insurance business, as well as improve the financial profitability of insurance companies, once a scenario of higher interest rates materializes.

Table 2.1.1.
Non-Life market: growth forecast for selected insurance markets, 2018-2020
(central scenario, nominal growth in local currency, %)

	Non-Life market		
	2018	2019	2020
Eurozone	3.0%	2.9%	2.9%
Spain	4.1%	4.1%	4.1%
Italy	1.7%	1.8%	1.8%
Germany	3.4%	3.0%	2.8%
United Kingdom	3.2%	3.5%	3.7%
Turkey	14.2%	12.4%	11.8%
United States	4.0%	3.8%	3.8%
Brazil	4.1%	10.7%	11.6%
Mexico	5.4%	10.0%	8.7%
Argentina	24.2%	20.8%	20.4%
Japan	-0.04%	-0.7%	-1.2%
Philippines	1.4%	3.6%	6.9%
China	11.8%	13.4%	15.0%

Source: MAPFRE Economic Research (ARIMA and Global Panel VAR models)
Forecast end date: January 8, 2019

Box 2.1.1
Measure of global insurance potential: the MAPFRE GIP

The MAPFRE GIP

The Global Insurance Potential Index (MAPFRE GIP) was constructed as a way of marking out the global insurance space. Based on an analysis of the economic and demographic factors that determine the behavior of the Insurance Protection Gap (IPG), the MAPFRE GIP makes it possible to develop a ranking that arranges a total of 96 insurance markets, both emerging and developed, according to their potential for contribution to the closure of the global IPG.

The factors employed are starting conditions and growth differentials, mainly relating to population, income level, penetration (premiums/GDP), density (premiums per capita) and elasticity of premiums with respect to the economic cycle. The simulation of the IPG for the 1997-2017 period shows that the model on which the MAPFRE GIP is based realistically reproduces the real behavior of the IPG. Thus, using economic and demographic forecasts, results were obtained for the 2017-2027 period, which give rise to the insurance gap closure potentials used in the calculation of the MAPFRE GIP*.

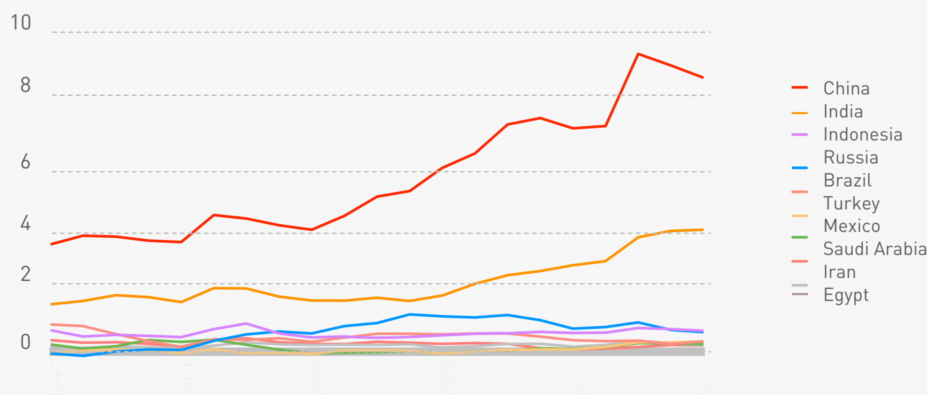
The Life and Non-Life ranking

The ranking developed on the basis of the MAPFRE GIP for the Life and Non-Life segments in a universe of 96 examined insurance markets identifies a number of markets with a high insurance potential: 24 for the Life segment and 25 for the Non-Life segment.

Within this group there is a series of insurance markets (designated as "Tier 1") which, while representing less than 5% of the analyzed sample, account for more than 50% of the global IPG. Logically enough, the largest economies are the ones that occupy the top places in the ranking, and they are also the ones with the capacity to close the insurance gap more quickly.

In the case of the Non-Life segment, Tier 1 is represented by China, India, the United States and Indonesia. These are followed by Russia, Japan, Germany, Brazil, Turkey and Mexico. Notable among all these countries are Russia and Turkey, which over the last decade have succeeded in moving up 7 places to enter the top 10. In the case of the Life segment, Tier 1 is made up of China, the United States, India, Japan and Russia, which are followed by Indonesia,

Chart A
Life: evolution of the MAPFRE GIP for the top 10 emerging markets, 1997-2017



Source: MAPFRE Economic Research

* The methodology used for calculating the MAPFRE GIP can be examined at: MAPFRE Economic Research, *Global Insurance Potential Index*, Madrid, Fundación MAPFRE, 2018.

Box 2.1.1 (continued)
Measure of global insurance potential: the MAPFRE GIP

Table A
Life and Non-Life: MAPFRE GIP (75th+ percentile of 96 countries), 2017

Life			
Market	Global ranking	MAPFRE GIP	Change in ranking vs 2016
Tier 1			
China	1	7.8	0
United States	2	3.9	0
India	3	3.6	0
Japan	4	1.3	0
Russia	5	1.0	1
Tier 2			
Indonesia	6	0.9	-1
Germany	7	0.8	0
Turkey	8	0.7	0
Brazil	9	0.6	4
Mexico	10	0.5	0
Iran	11	0.5	0
Saudi Arabia	12	0.5	-3
France	13	0.5	2
United Kingdom	14	0.5	0
Egypt	15	0.4	-3
Pakistan	16	0.4	0
Italy	17	0.4	2
South Korea	18	0.4	0
Nigeria	19	0.4	-2
Spain	20	0.3	0
Poland	21	0.3	1
Canada	22	0.3	2
Philippines	23	0.3	-2
Thailand	24	0.3	-1

Non-Life			
Market	Global ranking	MAPFRE GIP	Change in ranking vs 2016
Tier 1			
China	1	9.4	0
India	2	4.4	0
United States	3	4.3	0
Indonesia	4	1.2	0
Tier 2			
Russia	5	0.9	0
Japan	6	0.8	0
Germany	7	0.8	0
Brazil	8	0.7	0
Turkey	9	0.6	1
Mexico	10	0.6	-1
Iran	11	0.5	2
France	12	0.5	-1
Saudi Arabia	13	0.5	-1
Pakistan	14	0.5	3
Nigeria	15	0.5	1
United Kingdom	16	0.5	-2
Italy	17	0.5	-2
Egypt	18	0.4	0
South Korea	19	0.4	0
Spain	20	0.3	0
Thailand	21	0.3	0
Philippines	22	0.3	0
Bangladesh	23	0.3	1
Vietnam	24	0.3	-1
Poland	25	0.2	0

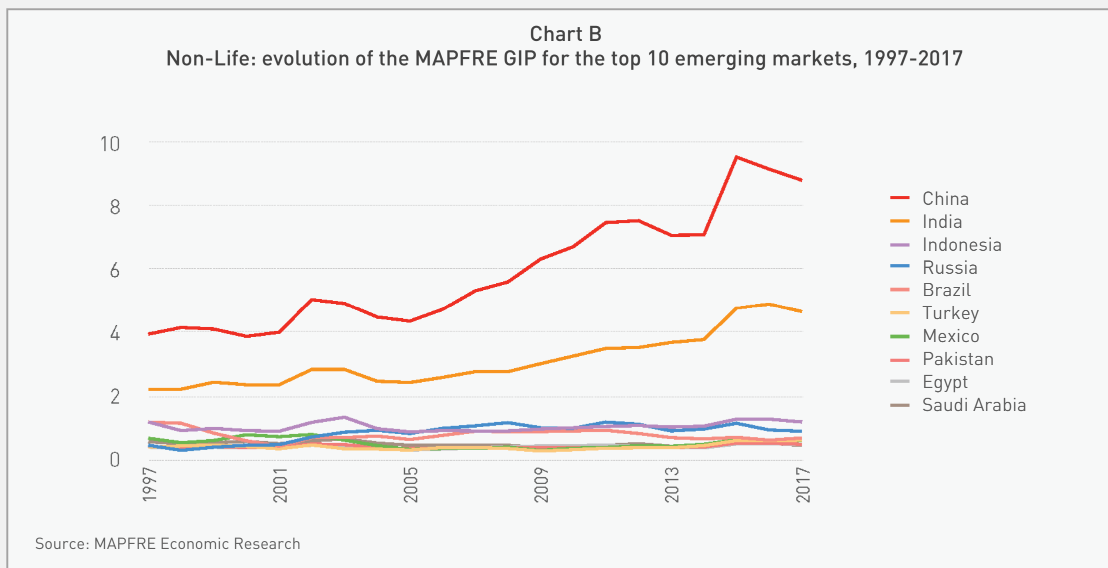
Source: MAPFRE Economic Research

Box 2.1.1 (continued)
Measure of global insurance potential: the MAPFRE GIP

Germany, Turkey, Brazil and Mexico. The main difference with respect to the Non-Life ranking is that Japan moves into fourth place at the expense of Indonesia, which falls into sixth place. Once again, Russia and Turkey are notable for their performance over the last decade, moving up 9 and 8 places during this period, respectively (see Table A and Charts A and B).

In conclusion, the GIP-MAPRE is a tool that, based on starting variables relating to population, economic activity and the performance of the insurance industry, performs a systematic measurement of the potential of the insurance business of each market, measured on the basis of their capacity to close the IPG. This indicator shows that the markets with the greatest potential are the large emerging countries, which, due to their size and capacity for closing the insurance gap, are converging toward penetration levels similar to those seen in the developed markets. The latter, for their part, derive their fundamental potential from the size already achieved by their insurance market rather than from their gap closure capacity, which is marginal.

Chart B
Non-Life: evolution of the MAPFRE GIP for the top 10 emerging markets, 1997-2017



Source: MAPFRE Economic Research

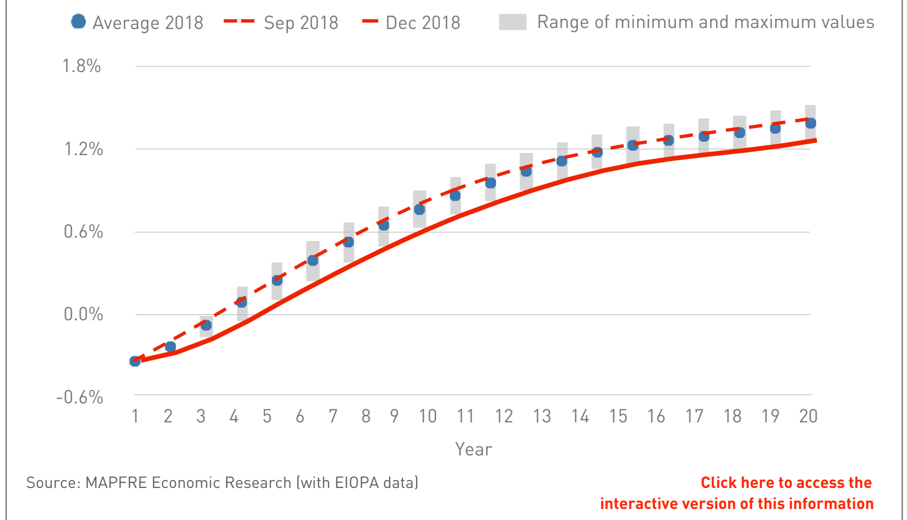
Table 2.1.1 shows nominal growth forecasts for insurance premiums in the Non-Life business, in a series of selected insurance markets.

2.1.2 Eurozone

The forecasts for real GDP growth in the eurozone for 2019 are at around 1.7%, which imply a slowdown compared to an estimated 1.9% growth in 2018, in line with the slowdown trend started in 2017 (2.5%). The economic growth forecast is explained by the slight slowdown of consumption and investment due to a worse outlook, the impairment of export markets and a slowdown in job creation. In any case, this context continues to be favorable for the development of the Non-Life and Life risk business lines of the insurance industry, although the expected slowdown will eventually affect the growth of these business lines. In Germany, a certain stagnation is observed, while debt and public deficit in Italy, protests in France, and the prospect of a no deal Brexit, elevate the level of uncertainty. Spain, for

its part, continues leading the growth of the eurozone's biggest economies, although its economy is also slowing down.

Chart 2.1.2-a
Eurozone: risk-free yield curve
(%)



Source: MAPFRE Economic Research (with EIOPA data)

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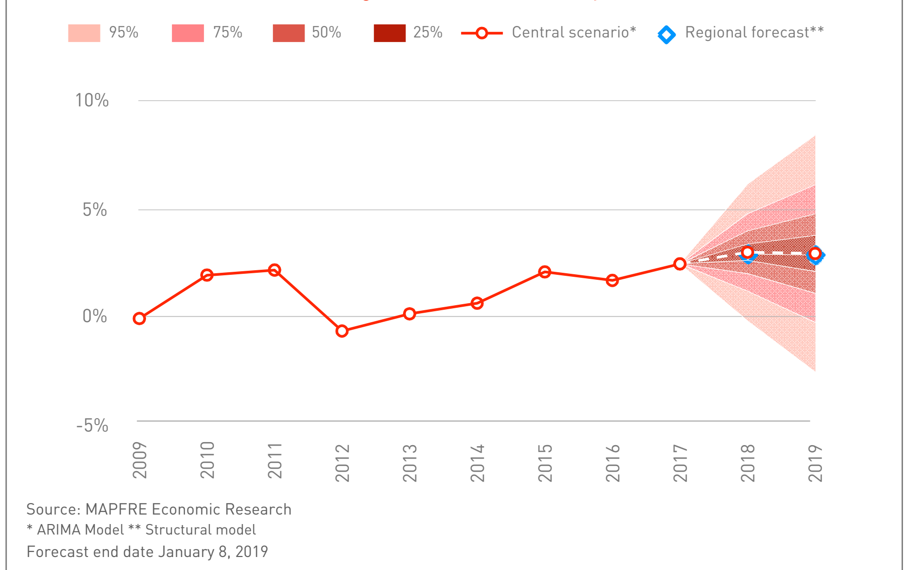
For its part, the ECB follows the expected monetary policy path, with weak core inflation. In December 2018, the net asset purchase program ended but the reinvestment of the principal of securities reaching maturity will continue, which could extend beyond the date when official interest rates start to rise and, in any case, for the period necessary to maintain favorable liquidity conditions. Monetary policy interest rates will continue at their current levels (0.0% refinancing rate and -0.40% deposit rate). The first rise in interest rates is not expected before the third quarter of 2019, with very gradual tightening as from this point, although with the European economy already in slowdown phase, uncertainty remains as to whether the ECB may raise interest rates as initially expected. EIOPA's risk-free yield curves show a drop in rates throughout the curve, reaching 2018 minimum levels. The curve still shows an upward slope, with higher rates with longer maturities, which could be a stimulus for the development of Life savings and annuity products, but the low levels of the rates make them very hard to market. The short section of the curve continues to present negative values. This sustained context of low interest rates continues to be prejudicial to the development of the specified lines of business. Chart 2.1.2-a shows minimum, average and maximum levels reached in 2018, and it also plots the latest risk-free yield curves published by EIOPA for September and December 2018.

In this context, we estimate that Non-Life insurance premiums in the eurozone could

Chart 2.1.2-b
Eurozone: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)



Source: MAPFRE Economic Research
* ARIMA Model ** Structural model
Forecast end date January 8, 2019

reach nominal growth of around 2.9% in 2019 (see Chart 2.1.2-b).

2.1.3 Germany

In Germany it is expected that real GDP growth will be around 1.7% in 2019, slowing down to 1.6% in 2020, similar to the growth experienced in 2018 (1.6%) and a long way off the growth of 2017 (2.5%). The main reasons for stagnation at these levels stem from international trade tensions and the expected loss of purchasing power of the target markets for its exports. This stagnation environment will affect the development of the insurance market's Non-Life and Life risk business lines, with growth rates decreasing slightly to around 3%.

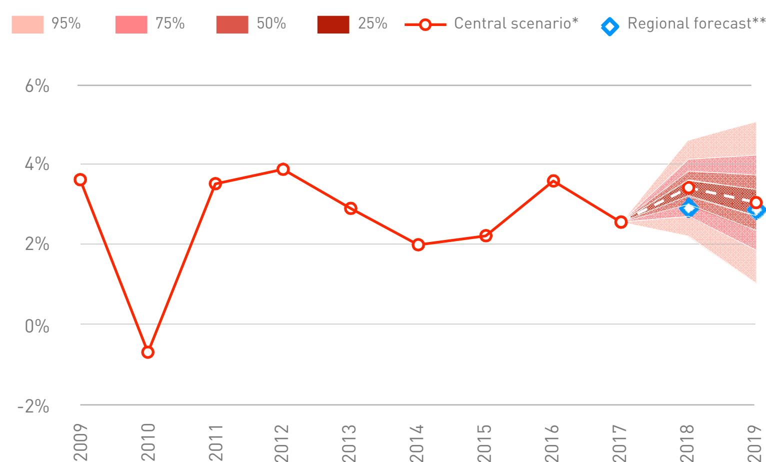
As for Life savings and traditional annuity insurance, the low interest rate outlook continues, which will continue to weigh on this business, particularly in Germany, where sovereign debt shows the lowest interest rate levels in the eurozone.

Thus we estimate that the nominal insurance premiums of the Non-Life segment will rise by around 3% in 2019 (see Chart 2.1.3).

2.1.4 Italy

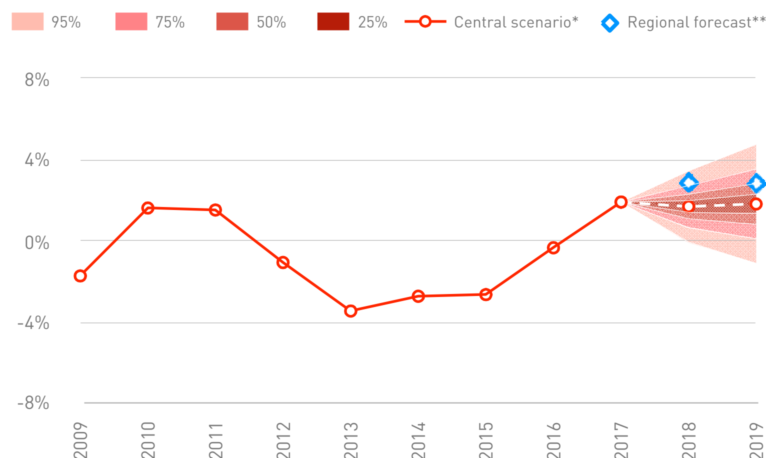
In Italy, estimated economic growth for 2019 is around 0.4% (0.9% in 2018), which implies a slowdown of its economy, in a global environment of low growth. Its high level of public debt and the new government's resistance to carrying out the necessary adjustments to balance public accounts is a vulnerability that affects its economy and the rest of the eurozone. The Italian government seems to be willing to give into some of the demands of the European Commission, faced with the prospect of an excessive deficit procedure

Chart 2.1.3.
Germany: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)



Source: MAPFRE Economic Research
* ARIMA model ** Structural model for Eurozone markets
Forecast end date: January 8, 2019

Chart 2.1.4.
Italy: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)



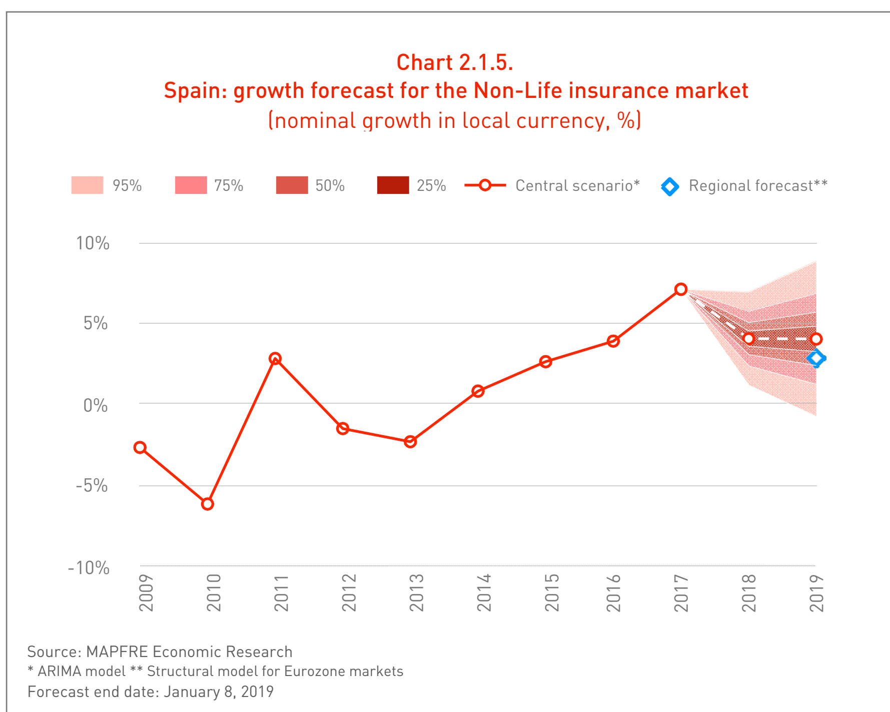
Source: MAPFRE Economic Research
* ARIMA model ** Structural model for Eurozone markets
Forecast end date: January 8, 2019

based on its debt levels, but the Italian political environment maintains a high level of uncertainty. This low economic growth environment is unfavorable for the development of the insurance market's Non-Life and Life risk business lines, which will also experience weak growth.

As for Life savings insurance and traditional annuity insurance, the low interest rate outlook persists, which will continue to weigh on this business across the eurozone. However, the increase in the risk premium of Italian sovereign debt, whose 10-year bond has experienced significant upturns in the last few months of 2018 (with profitability at times close to 3.7%) may stimulate this business, also on an ad-hoc basis, without prejudice to the vulnerabilities that may accumulate in the balance sheets of the insurance companies taking advantage of these upturns.

In this context, we estimate that the insurance premiums of the Non-Life segment will rise in nominal terms by around 1.8% in 2019 (see Chart 2.1.4).

Chart 2.1.5.
Spain: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)



Source: MAPFRE Economic Research
* ARIMA model ** Structural model for Eurozone markets
Forecast end date: January 8, 2019

2.1.5 Spain

In Spain it is expected that real GDP growth in 2019 will be around 2.3% (2.6% in 2018), and will continue to be one of the eurozone's growth drivers. This growth will continue to lean on family consumption and private investment, although they will grow at a slower pace than in 2018. This slowdown will affect private investment to a larger extent. Despite the slight slowdown expected, the growth of the Spanish economy in real terms means that the forecast continues to be favorable for the development of the Non-Life and Life risk business lines of the insurance market, although with lower growth than in previous years. The risks that may affect the Spanish economy and the performance of the insurance industry include the possibility of an increase in risk premiums, whether by contagion from other peripheral countries, or due to economic policy decisions that increase the uncertainty regarding the sustainability of public accounts.

As regards Life savings and traditional annuity insurance, as is the case across the eurozone, the low interest rate outlook persists, which will continue to weigh on this business. In line with the message from previous reports, it is important to note that the innovation in the insurance industry toward products in which the investment holder assumes the risk of investment or traditional products that make the most of the positive slope of the rates curve has not ceased, in a context of interest rates that is negatively offsetting the effect that the improvement seen in the Spanish economy could have on these business lines. The drops and the increase in volatility experienced in securities markets at the end of the year do not make it easy to market of this kind of products either.

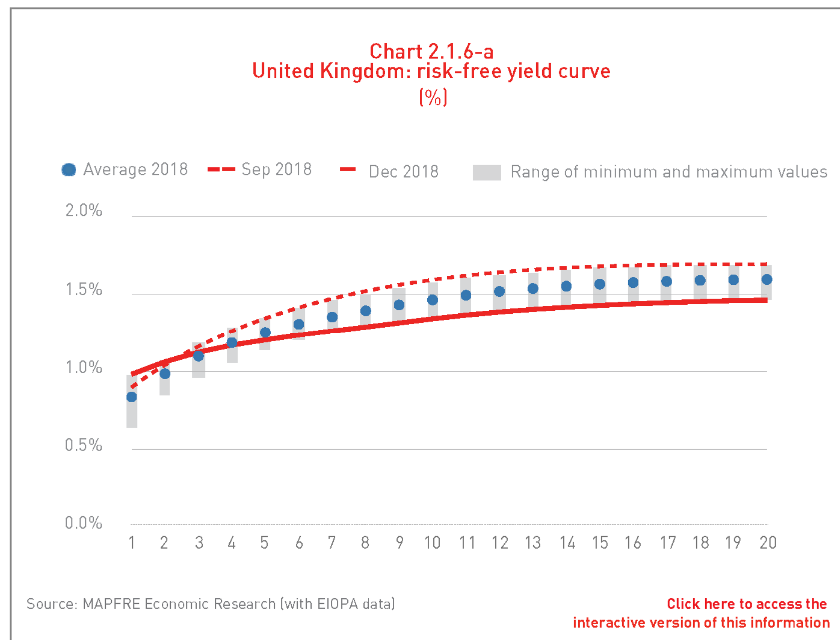
Thus we estimate that the insurance premiums of the Non-Life segment will rise in nominal terms by around 4.1% in 2019 (see Chart 2.1.5).

2.1.6 United Kingdom

The real economic growth forecast for 2019 in the United Kingdom could come to around 1.2%, similar to that of 2018 and a far cry from the growth experienced in years prior to the referendum on exiting the European Union. The slowdown of private investment and postponement of consumer decisions due to the uncertainty generated, continue to hold back growth. However, unemployment rates remain low (around 4%) and growth can be observed in real salaries. This environment will influence the development of the insurance business, which can maintain and even increase real growth in insurance premiums over the next two years, although there is a high level of uncertainty regarding such growth. The upturn in inflation and the depreciation of the pound sterling may also negatively affect the cost of insurance company claims.

As regards Life savings and traditional annuity insurance in the United Kingdom, the low interest outlook still persists and will continue to hold back this business line. The risk-free yield curves created by EIOPA (see Chart 2.1.6-a) show that short-term rates have experienced a slight upturn in December compared to September, reaching maximum levels for 2018, but the level continues to be low and the curve is flattening in such a way that rates for maturities exceeding seven years have dropped to their minimum levels for the year, which is unfavorable for the development of this

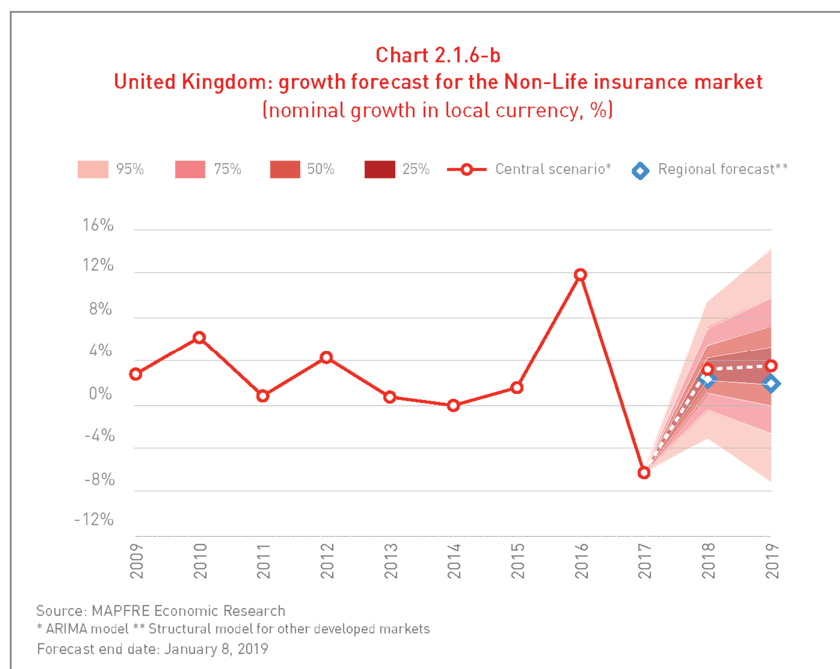
Chart 2.1.6-a
United Kingdom: risk-free yield curve
(%)



Source: MAPFRE Economic Research (with EIOPA data)

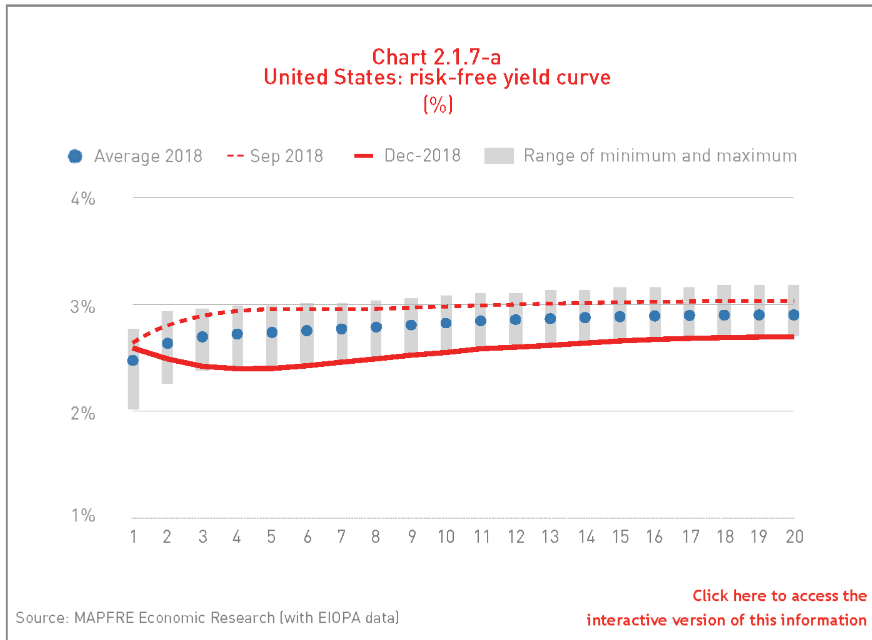
Click here to access the interactive version of this information

Chart 2.1.6-b
United Kingdom: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)



Source: MAPFRE Economic Research
* ARIMA model ** Structural model for other developed markets
Forecast end date: January 8, 2019

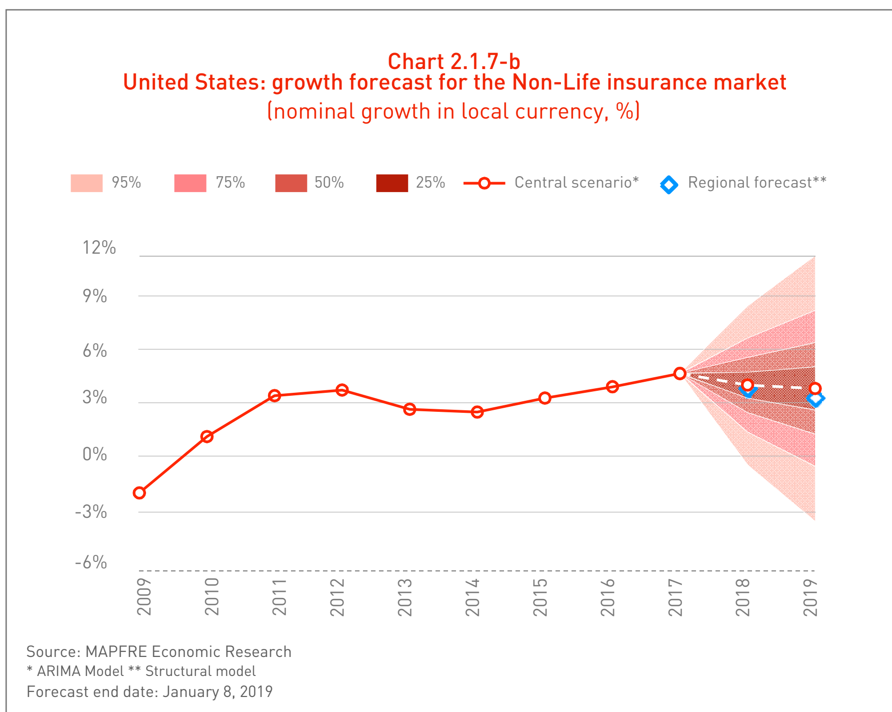
kind of product, given that one cannot benefit from the term premium, which has dropped. Furthermore, the drops witnessed in securities markets at the end of 2018 and the rise in volatility may damage the development of the insurance products in which the policyholder assumes the risk of the investment, which have a wide distribution in this market.



In this context, we estimate that Non-Life insurance premiums could experience growth, in nominal terms, of around 3.5% in 2019 as a central scenario (see Chart 2.1.6-b).

2.1.7 United States

The economic growth envisaged for 2019 in the United States may come in at around 2.5% (as compared with 2.9% in 2018). Private investment still experiences notable growth, and the unemployment rate is at minimum levels (3.7% in December). Gradual growth of real salaries continues to support the increase in disposable income and private consumption. The economy is still in a high point, in an environment that continues to be favorable for the insurance industry, especially in terms of the Non-Life and Life risk and annuity insurance business, due to the additional boost provided by the rise in interest rates for these business lines. For 2019, a gradual and ordered cycle change is expected, that would entail a gradual slowdown in the growth of the insurance business, mainly of the Non-Life business. However, there are risks for the economy deriving from high levels of public debt and the effects of the trade war, which could result in a stronger adjustment than initially envisaged.



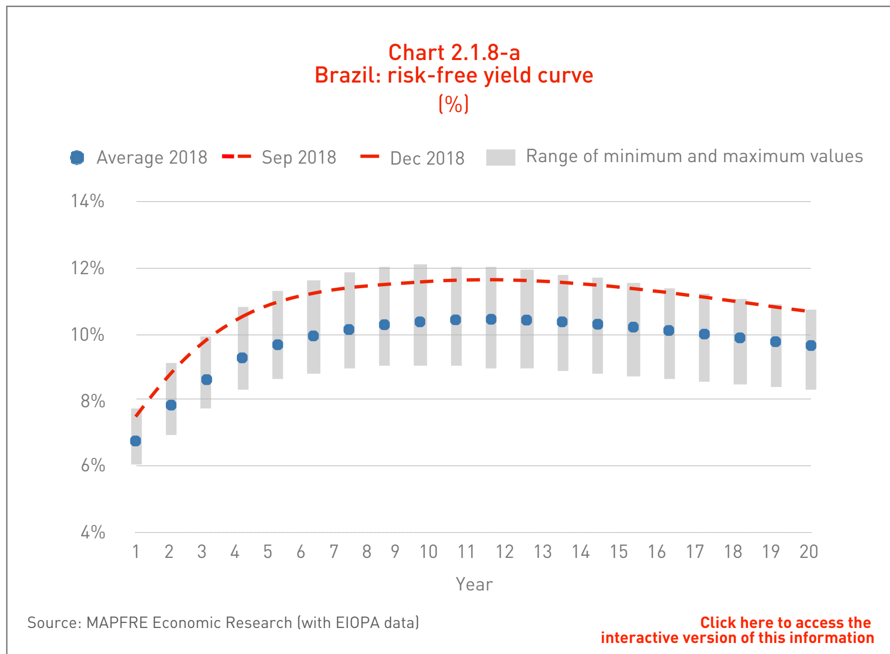
Inflation remains close to the Federal Reserve objective. Following the four interest rate hikes in 2018, a further two increases are expected in 2019. EIOPA's risk-free yield curves (see Chart 2.1.7-a) show that the latest rises are not occurring throughout the curve, and there is a section with a slight downward slope for maturities under five years. The December curve has dropped compared to that of September, and for maturity terms exceeding two years it is at minimum levels for 2018. A flattened curve and expectations that rates may go back up again could curb the demand for savings products, especially those which offer medium and long-term interest rate guarantees. However, the greatest rises have already taken place and it is envisaged that they will stabilize, following the two increases forecast for 2019. The downward slope of the curve may be an opportunity to market temporary Life savings products that are renewable for short terms, allowing a review of the rate guaranteed in each renewal, for companies agile enough to adapt their range of products in this environment.

In this context, we estimate that Non-Life insurance premiums may experience nominal growth rates of around 3.8% in 2019, as a central scenario (see Chart 2.1.7-b).

2.1.8 Brazil

In Brazil, it is envisaged that real 2019 GDP growth will be around 2.3% (1.2% in 2018). This improvement in the outlook can mainly be attributed to a recovery of private consumption and investment. The election of Jair Bolsonaro as the new president of Brazil has been well received by the markets. However, there remains a significant imbalance in the public

Chart 2.1.8-a
Brazil: risk-free yield curve
(%)



Source: MAPFRE Economic Research (with EIOPA data)

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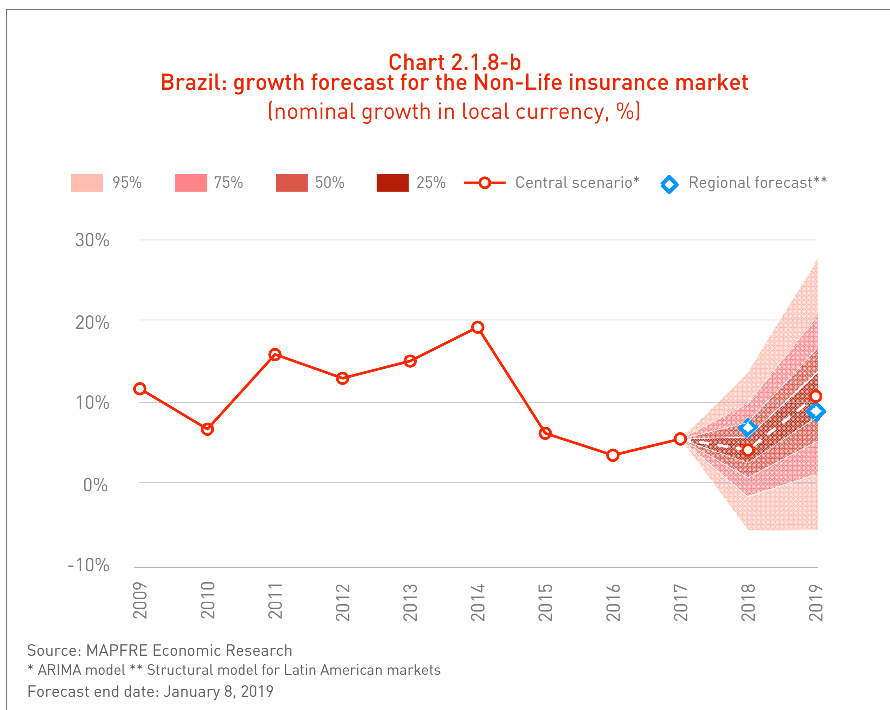
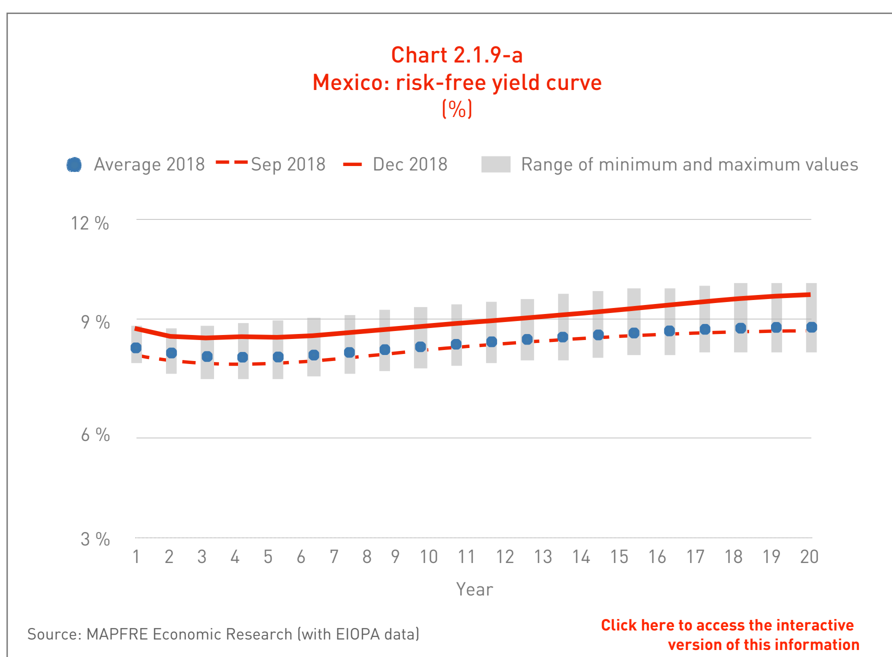
Chart 2.1.8-b
Brazil: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)



Source: MAPFRE Economic Research
* ARIMA model ** Structural model for Latin American markets
Forecast end date: January 8, 2019

accounts, meaning that the structural reforms needed to balance them continue to be indispensable, especially in the pensions system. For the moment, the environment improves for the Non-Life and Life risk business of the insurance industry, given their strong link with the behavior of the economic cycle. Inflation is slightly above the objective of the central bank and the exchange rate seems to have stabilized. If inflation remains at these levels, it may negatively affect the cost of claims, by eroding the profitability of the insurance business.



The central bank has reduced the monetary policy benchmark interest rate, but the monetary stimulus may be gradually removed in the event that the inflation outlook also worsens. The risk-free yield curves produced by EIOPA (see Chart 2.1.8-a) show a significant drop in rates in the month of December compared to the September curve. This drop has affected the rest of the yield curve, which sees a sharp fall in all its maturities. This environment is unfavorable for the development of the Life savings and annuity insurance business, which will suffer, especially if we consider the high rates that existed in Brazil in recent years.

Thus, we estimate that Non-Life insurance premiums will experience nominal growth rates of around 10.7% in 2019 (not discounting inflation), as a central scenario (see Chart 2.1.8-b).

2.1.9 Mexico

We estimate real growth of the Mexican economy in 2019 of around 2%, the same growth as that forecast for 2018. The economy performed well, mainly due to the improved performance of the external sector and the lower unemployment rate. This environment continues to be favorable for the development of the insurance market's Non-Life and Life business segments, supported by positive economic growth in real terms and by a low level of insurance penetration in Mexico. Among the risks that may influence the behavior of the Mexican economy and its insurance industry is the uncertainty caused by the way that decisions relating to economic policy have been adopted, which has led to suspending a significant infrastructure project in terms of GDP, namely the Mexico City airport project, which could be seen again in other strategic sectors.

Inflation was at 4.8% in the last quarter of 2018, and is expected to continue moderating, following the rate rise by the Bank of Mexico and the fall in the price of oil. This will favor the profitability performance of the Non-Life business lines, which was affected negatively by the upturn of previous months, due to the increase of claim-derived expenses. The increase in short-term rates and the recovery of the currency following its depreciation during the last quarter of the year is also a positive piece of news for the profitability of these business lines, and for the cost of coverage through reinsurance, for which contracts are usually renegotiated in dollars.

In December, the Bank of Mexico raised the monetary policy benchmark rate to 8.25%. EIOPA's risk-free yield curves (see Chart 2.1.9-a) show an upturn in all sections of the curve compared to the level it showed at the end of September, above the average values for 2018. The curve continues to show a slight downward slope in maturities with terms under six years. This environment continues to be favorable for Life savings and annuity products, making the most of the long-term rate levels, as well as temporary Life savings products, renewable for periods of less than a year, which allow for a review of the guaranteed rate at each renewal.

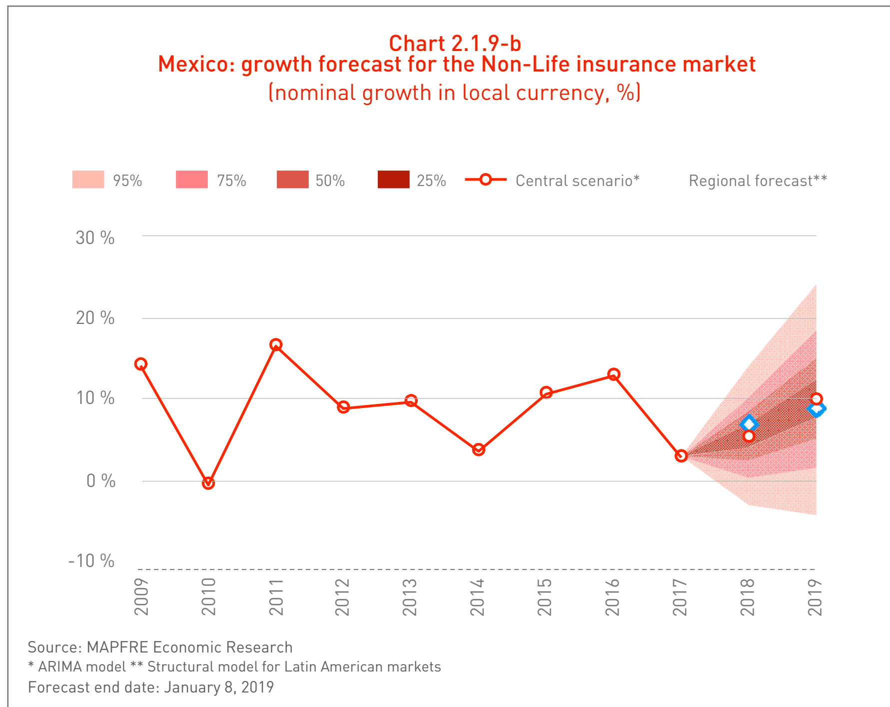


Chart 2.1.9-b
Mexico: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)

Source: MAPFRE Economic Research
* ARIMA model ** Structural model for Latin American markets
Forecast end date: January 8, 2019

In this context, we estimate that Non-Life business premiums will rise in nominal terms by around 10% in 2019, as a central scenario (see Chart 2.1.9-b).

2.1.10 Argentina

The forecast for the Argentine economy in 2019 is a GDP drop in real terms of around -1.3% (-2.5% in 2018). The IMF aid program is taking effect as regards currency stabilization, and points to an improvement of the medium-term outlook. However, Argentina must continue to apply the measures that enable it to reduce the macroeconomic imbalances that triggered the crisis which began in the first half of 2018. The high interest rates and fiscal adjustment that it must carry out mean that the economy is not forecast to come out of the recession until 2020.

This environment will negatively affect the development of the Non-Life and Life risk

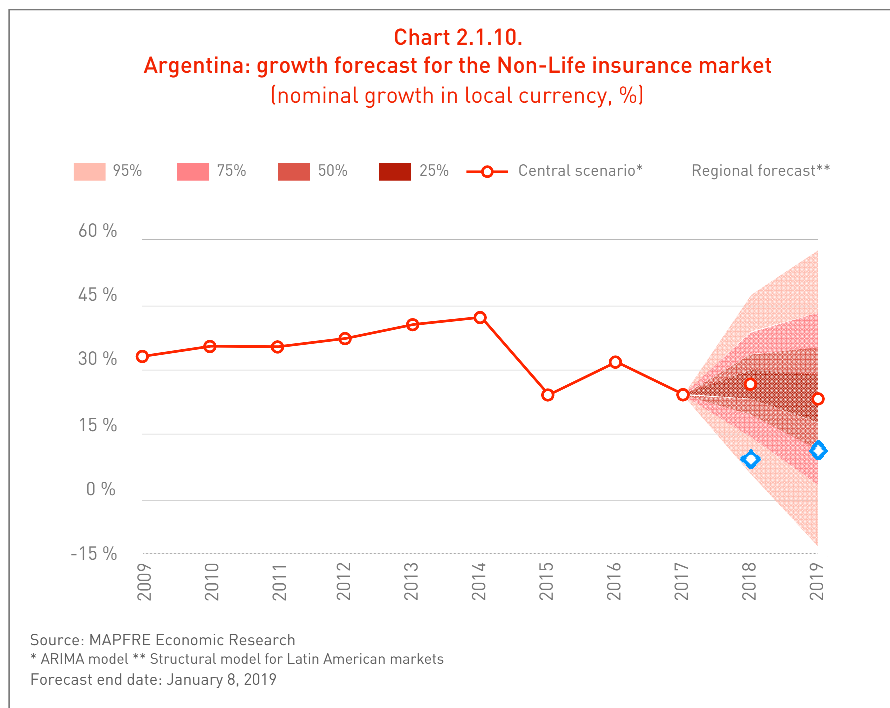
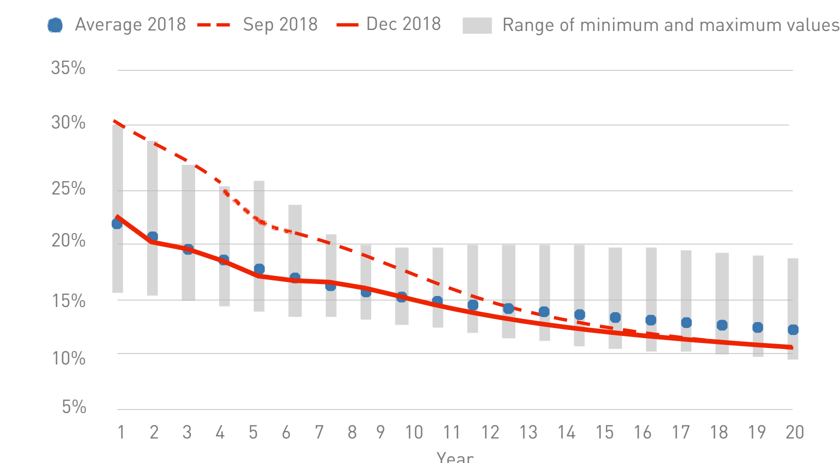


Chart 2.1.10.
Argentina: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)

Source: MAPFRE Economic Research
* ARIMA model ** Structural model for Latin American markets
Forecast end date: January 8, 2019

business lines of the insurance industry. The high inflation rates and the currency depreciation, in turn, will negatively affect the cost of claims of insurance companies which, furthermore, cannot fully benefit from the high monetary policy interest rates to underpin the financial profitability of these business lines, due to regulatory limitations. This interest rate environment could also be an opportunity to market annual savings Life insurance products that are temporary and renewable with short maturity terms, offering a renegotiation of the guaranteed rate for each maturity term, but the aforementioned regulatory limitations make the development of this kind of product difficult.

Chart 2.1.11-a
Turkey: risk-free yield curve
(%)



Source: MAPFRE Economic Research (with EIOPA data)

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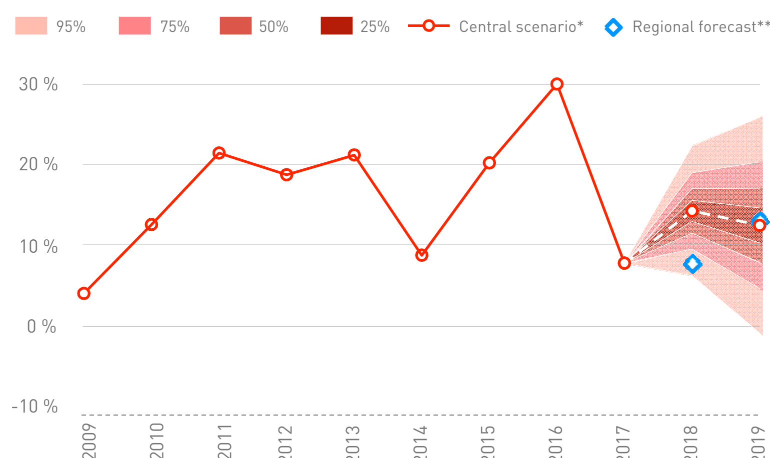
Chart 2.1.11-b
Turkey: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)



Source: MAPFRE Economic Research
* ARIMA model ** Structural model for Emerging European markets
Forecast end date: January 8, 2019

In this context, we estimate that Non-Life business premiums will experience a nominal increase of around 20.8% in 2019 as a central scenario which would translate into real negative growth if the predictions of high levels of inflation are taken into account (see Chart 2.1.10).

2.1.11 Turkey

In Turkey it is predicted that the GDP will fall by -1.7% in 2019 in real terms. Estimated growth for 2018 is around 3.2% (7.4% in 2017), below the initial forecast, due to the strong slowdown witnessed in the second half of the year. For the moment, it seems that the markets have given Turkey and the lira a respite, after the country hardened its monetary policy and the government presented its three-year economic plan. However, there are still vulnerabilities deriving from the excess stimuli that led to excessive demand and an imbalance in the balance of payments. The main production and confidence indicators signal a clear slowdown,

and the employment market has suffered, with a significant increase of the unemployment rate in the last quarter.

This environment will negatively affect the development of the Non-Life and Life risk business lines of the insurance industry, which was also affected by the price control system in mandatory third-party liability automobile insurance. High inflation rates and currency depreciation, in turn, will negatively affect the cost of claims of insurance companies, although the high monetary policy interest rates may help to underpin the financial profitability of these business lines. These rises in rates seem to be taking effect, and inflation dropped to 20.3% in December from 25.4% in October, helped by a recovery of the lira (from 20% from the minimum summer levels) and by the drop in the price of oil. However, the risk of volatility in the currency exchange rate is still high.

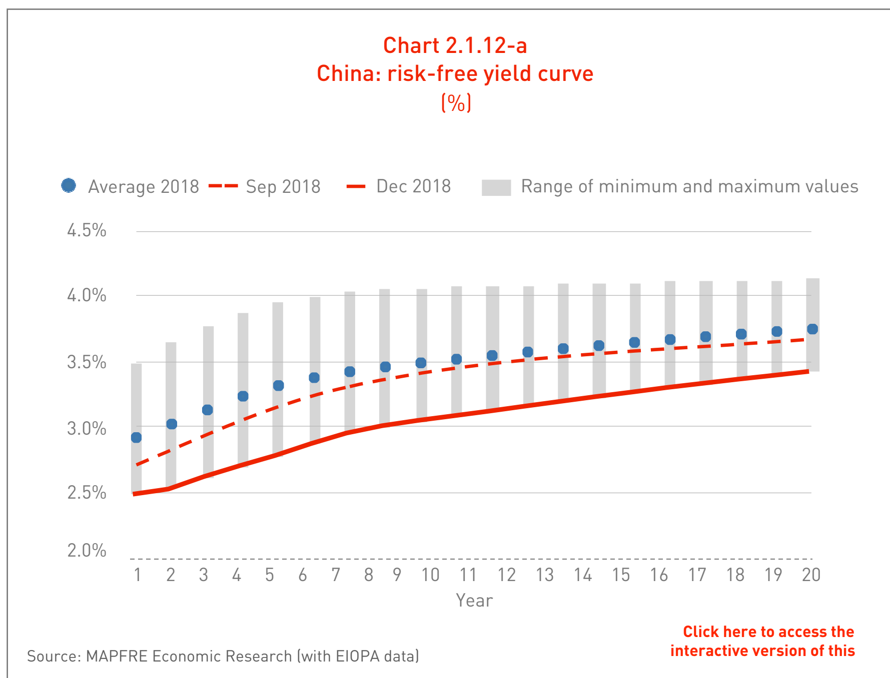
For its part, as can be seen in the risk-free yield curves produced by EIOPA (see Chart 2.1.11-a), there continues to be high volatility in the performance of interest rates, with a completely inverted curve. It can be observed that the December curve has dropped significantly compared to that of the month of September, a symptom of a certain normalization of the problems suffered by the Turkish economy and its currency in the last few quarters. However, this environment is detrimental for the development of products with long-term guarantees in the Life savings and annuity businesses due to the inversion of the yield curve. To the above is added the high volatility of short-term rates and the fall suffered in the last quarter which also hinders the marketing of short-term temporary renewable Life products, which provide for revision of the guaranteed rate at the time of each renewal, although this type of product continues to be a business opportunity in this environment.

In this context, we estimate that the Non-Life insurance premiums will grow, in nominal terms, by around 12.4% in 2019 as a central scenario, which would translate into real negative growth taking into account the high inflation rate forecasts (see Chart 2.1.11-b).

2.1.12 China

The forecast for the Chinese economy is for GDP growth of around 6.2% in 2019, in real terms (6.6% in 2018). Investment and consumption continue to be the drivers of growth, but the increase in trade tensions with the US, and the slowdown in credit growth points to a drop in the real growth of its economy that will be accentuated in 2020 (5.8%). The Chinese government is considering the adoption of infrastructure expenditure growth and tax reduction measures to give a fiscal boost to its economy. This would increase an already elevated debt level, which is its main vulnerability. In any event, the outlook continues to be favorable for the prospects of the Non-Life and Life risk insurance business, aided by the still low rate of penetration in

Chart 2.1.12-a
China: risk-free yield curve
(%)

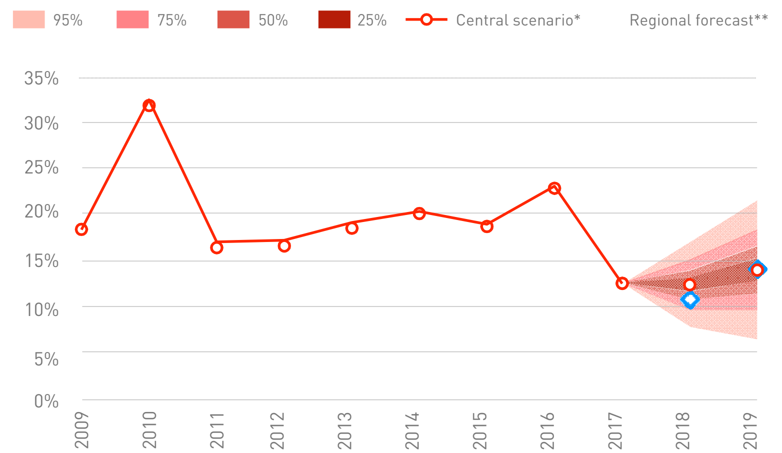


Source: MAPFRE Economic Research (with EIOPA data)

Click here to access the interactive version of this

China, common to emerging economies, which results in increased elasticity in premium growth as GDP increases. It should be noted, as we have mentioned in previous reports, that the Chinese government's specific objectives include increasing the penetration rate. The inflation outlook (2.1%) and the stability of its currency also favor the development of this business.

Chart 2.1.12-b
China: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)



Source: MAPFRE Economic Research
* ARIMA Model ** Structural model
Forecast end date: January 8, 2019

As for the Life savings and annuities businesses, the risk-free yield curves of EIOPA (see Chart 2.1.12-a) show that interest rates continue to decline, due to the flexibilization of the monetary policy implemented to support growth. The curve maintains an upward slope, although its continuous decline makes interest rates in all maturities reach the minimum levels of 2018, which can make it hard to market new products for these business sectors.

In this economic context, we estimate that Non-Life business premiums will experience- growth rates of around 13.4% in 2019, as a central scenario (- Chart 2.1.12-b).

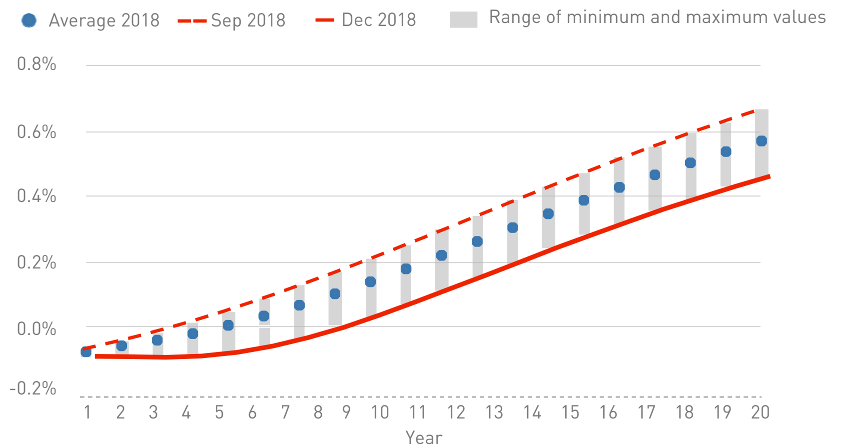
2.1.13 Japan

The forecast for the Japanese economy is for GDP growth of around 1% in 2019 (0.8% in 2018).

Its economy suffered a significant contraction in the third quarter of 2018 (-2.5% QoQ) caused by the impact of natural disasters and a weaker foreign trade environment. The weak economic performance makes for a forecast of an also weak performance in terms of growth of the Non-Life and Life risk insurance business, which is expected to possibly experience a regression in terms of premiums in the next two years.

In the risk-free yield curves produced by EIOPA (see Chart 2.1.13-a) a decline in rates can be

Chart 2.1.13-a
Japan: risk-free yield curve
(%)



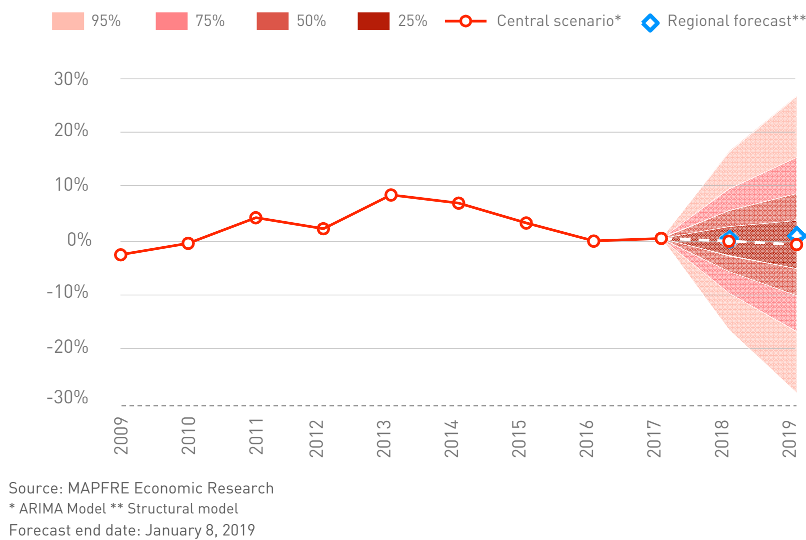
Source: MAPFRE Economic Research (with EIOPA data)

Click here to access the interactive version of this information

observed throughout the curve in the month of December as compared with the levels in September, at the minimum levels for 2018. The curve shows negative values for maturities of up to eight years, and the term premium as from these maturities continues to be very low, which makes it very hard to market Life savings and annuity products. This sustained context of low interest rates continues to be detrimental to the development of the specified lines of business. Furthermore, the drops witnessed in securities markets at the end of 2018 and the rise in volatility may also damage the development of insurance products in which the policyholder assumes the risk of the investment.

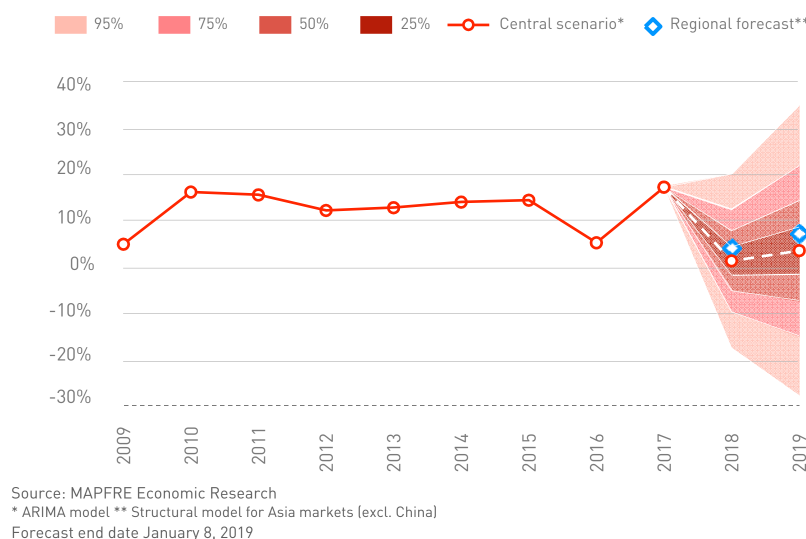
In this context, we estimate that Non-Life business premiums will experience a nominal drop of around -0.7% in 2019 as a central scenario (see Chart 2.1.13-b).

Chart 2.1.13-b
Japan: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)



Source: MAPFRE Economic Research
* ARIMA Model ** Structural model
Forecast end date: January 8, 2019

Chart 2.1.14.
Philippines: growth forecast for the Non-Life insurance market
(nominal growth in local currency, %)



Source: MAPFRE Economic Research
* ARIMA model ** Structural model for Asia markets (excl. China)
Forecast end date January 8, 2019

2.1.14 Philippines

The forecast for the Philippine economy in 2019 is GDP growth in real terms of around 6.2% (6.3% in 2018). It is a slight slowdown, which would rise slightly in 2020 (5.8%). The driver for growth comes from the domestic market with significant growth in investment and private consumption. However, the trade deficit was extended significantly in the last quarter of 2018 and has been deteriorating now for four years. In any event, the economic growth outlook is favorable for the prospects of the Non-Life and Life risk insurance business, with the help of the still low rate of penetration of insurance in the

Philippines common to emerging economies, which results in greater elasticity in the growth of premiums in response to GDP growth. However, if the high inflation rate registered in 2018 (6.0%) is not corrected, it may negatively affect the cost of insurance company claims.

Furthermore, with the aim of controlling inflation, the central bank has been raising the monetary policy benchmark rate since May 2018, which was at 3%, to 4.75%, and the profitability of the 10-year sovereign bond at year end was above 7%, with no significant increases being envisaged in the next two years. This rates environment together with the economic growth situation is favorable for the development of the Life savings and annuities business lines.

Thus, we estimate that Non-Life business premiums will experience a nominal growth rate of around 3.6% in 2019, as a central scenario (see Chart 2.1.14).

2.1.15 Reinsurance

There was no significant singular natural disaster event in 2018, but the aggregate losses of a series of smaller and medium-sized events, together with some larger human-induced disasters, have caused considerable insured losses. According to preliminary estimations by Swiss Re, economic losses caused by natural disasters and anthropogenic incidents in 2018 amounted to 155 billion dollars, compared to 350 million in 2017. Global insured losses are estimated at around 79 billion dollars, that is, more than 50% of all economic losses. This figure is lower than the 150 billion of 2017, but higher than the annual average of the last 10 years. Natural disasters represented 71 billion dollars and human-induced disasters account for the remaining 8 billion dollars.

The catastrophic events of 2018 included: hurricanes Michael and Florence; typhoons Jebi, Trami and Mangkhut; heat waves, droughts and forest fires in Europe and California; winter and thunderstorms across the whole world; floods in Japan and India; earthquakes in Japan, Indonesia and Papua New Guinea, and volcano eruptions in Hawaii.

Hurricane season in the Atlantic has been marked in 2018 by hurricanes Florence and Michael, which crossed parts of the southeast of the United States in September and October of 2018, leaving dozens dead and causing millions of dollars' worth of losses. Florence, with winds of up to 220 kilometers per hour (140 m/h), caused floods that devastated parts of North and South Carolina. After hitting the islands of Cape Verde and Bermuda, on September 14 Florence landed on Wrightsville Beach, North Carolina, where according to the state government it caused damages worth 12.7 billion dollars. In South Carolina, the damages amounted to 1.2 billion dollars.

On the other hand, the category 4 Michael, which landed on the northeast of Florida on October 10, 2018, caused the greatest damage in the United States, but in Cuba the wind and rains left thousands of homes without electricity, and caused floods and damage on the western tip of the island. According to records of the National Oceanic and Atmospheric Administration (NOAA), Michael is the strongest hurricane to have hit Florida's northwestern area to date. Mexico Beach and Panama City were the sites worst hit by the hurricane in its passing through Florida, a state in which there were more than 1.5 billion dollars' worth of agricultural losses, according to data from the Florida Commissioner of Agriculture.

The Insurance Commissioner of California Department of Insurance stated that, according to preliminary data, insured losses from the November fires (the so-called "Camp Fire", in the north of the state and "Woolsey Fire" and "Hill" in the south) amount to 9.05 billion dollars, although it is expected that numbers will go up as more claims are filed and processed. To date, the fire named "Camp Fire" is the deadliest fire in the history of the state of California. The fire, which started on November 8, 2018, almost completely wiped out the town of Paradise, home to 26,000 inhabitants and located 280 kilometers to the northeast of the San Francisco Bay area, burned 62,052 hectares of land, destroyed 18,793

structures and took the lives of 85 people, representing a cost of 7 billion dollars for insurers.

On the other hand, as regards the second half of the year in Spain, the Insurance Compensation Consortium (CCS as per its Spanish acronym) expects to receive 16,600 claim requests for the floods that took place between the October 8 and 10 in Mallorca and in the provinces of Tarragona and Malaga, caused by the storm known as Leslie, which especially affected Catalonia, and due to the floods that took place between the October 17 and 21, which affected the provinces of Malaga, Castellón, Valencia, Tarragona and western Andalusia, mainly Seville. The CCS calculates that it can pay approximately 80 million euros to the policyholders affected by said events.

2.2 Regulatory trends

2.2.1 Global trends

IAIS

On October 30, 2018, the deadline ended for the submission of comments on the new version of the future International Capital Standard "ICS Version 2.0"[19] prepared by the *International Association of Insurance Supervisors* (IAIS). The IAIS is now analyzing the responses received to continue moving forward in the process of adopting the final standard scheduled for the end of 2019.

IFRS 17

Furthermore, after considering the request to delay the term for entry into force of the International Financial Reporting Standard (IFRS) 17 on Insurance Contracts (IFRS 17), the International Accounting Standards Board (IASB) agreed to delay the application of this accounting standard by one year, so that it would be applicable for the preparation of the consolidated accounts of listed insurance groups for 2022.

2.2.2 European Union

EIOPA Stress Test 2018

In December 2018, the European Insurance and Occupational Pensions Authority (EIOPA) published the results of the stress test on large European insurance groups carried out on a biennial basis. There are some new developments in this new test carried out by EIOPA with the cooperation of the European Systemic Risk Board (ESRB). First, the scope is greater than the 2016 test, as it assesses the solvency situation at group level and not at the level of individual entities. As a result, this year there are no aggregate results at national level.

The second development worth noting in this exercise is that the results are shown not only at the aggregate level but also incorporate disaggregated public information about certain groups that have voluntarily agreed to its publication. 42 insurance groups have participated in this *stress test* with total consolidated assets of 7.27 trillion euros representing around 75% of all European insurance groups at the end of 2017. However, at this time only four groups have consented to the publication of the results of their respective impact studies [20].

Finally, it is worth noting that the calculations made by the participating groups have been made using the same models as those applied to calculate the solvency capital required to be reported to the supervisors. Of the 42 participating groups, 3 have used full internal models, 19 partial internal models and the rest the standard formula.

The aforementioned test considered three simulated adverse scenarios:

Scenario 1 ("Yield Curve Up" or "YCup")

This scenario simulates a sudden and significant change in the assessment of risk premiums in global financial markets, causing a tightening of financial conditions and impacting global prices of sovereign, corporate,

Table 2.2.2.
EIOPA stress test: summary of impacts per asset class for the main markets of the European Union and in the United States
(bonds: increase in risk premiums; real estate and equities, percentage of their assessment)

	Countries					
	Germany	Spain	France	Italy	United Kingdom	United States
1-year rate sovereign bonds shock (bps)	83	185	127	155	107	173
5-year rate sovereign bonds shock (bps)	133	246	164	225	149	187
10-year rate sovereign bonds shock (bps)	119	222	149	205	130	175
20-year rate sovereign bonds shock (bps)	104	183	126	172	115	169
Non-financial AAA corporate bonds shock (bps)	138	138	138	138	138	196
Financial AAA corporate bonds shock (bps)	147	147	147	147	147	205
Non-financial AA corporate bonds shock (bps)	178	178	178	178	178	235
Financial AA corporate bonds shock (bps)	199	199	199	199	199	256
Non-financial A corporate bonds shock (bps)	218	218	218	218	218	275
Financial A corporate bonds shock (bps)	250	250	250	250	250	307
Non-financial BBB corporate bonds shock (bps)	258	258	258	258	258	291
Financial BBB corporate bonds shock (bps)	301	301	301	301	301	398
AAA RMBS shock (bps)	156	156	156	156	156	170
AA RMBS shock (bps)	176	176	176	176	176	194
A RMBS shock (bps)	196	196	196	196	196	218
BBB RMBS shock (bps)	240	240	240	240	240	272
Shares shock (%)	-40%	-40%	-43%	-40%	-37%	-38%
Residential buildings shock (%)	-23%	-23%	-17%	-12%	-21%	-31%
Commercial buildings shock (%)	-33%	-34%	-31%	-24%	-31%	-28%

Source: MAPFRE Economic Research (based on EIOPA data)

equity and real estate bonds. As a result, policy redemptions are significantly increased. In addition, higher-than-expected inflationary pressures lead to insufficiencies in the provision of general insurance benefits.

Table 2.2.2 shows a summary of some of the impacts to be applied per asset class for the main markets of the European Union and in the United States. The shocks applicable to the bonds are expressed in terms of increased spreads (risk premiums), while those of real estate and equity are expressed as a percentage of their assessment. In the baseline scenario, asset allocation by category was 24.3% in sovereign bonds (with an average modified duration of 7.4 years) and 20.9% in corporate bonds (with an average modified duration of 6 years). Of the remaining total, 24.1% were unit-linked and index-linked assets, 7.4% were investment fund shares, 5.3% were investments in associated companies, 3.6% were investments in equities, 2% were real estate for non-proprietary use, and the rest were other types of assets.

Moreover, Chart 2.2.2-a shows the *shocks* in the risk-free interest rates derived from the simulated increase in swap rates for the main currencies: euro, dollar and pound sterling.

Scenario 2 ("Yield Curve Down" or "YCdown")

This second scenario simulates a long-term prolongation of the environment of low interest rates combined with an increase in life expectancy over and above what is expected. This environment increases the assessment of long-term obligations of insurers and reduces the margins between guaranteed rates in life insurance policies and those obtained in the investment portfolios that support these obligations.

Scenario 3 ("Natural Catastrophe" or "NC")

Finally, the third scenario is an extreme scenario in which a series of natural catastrophes occur in Europe, including storms, floods and earthquakes.

Situation after the impacts

This exercise involved 25 of the 42 groups that underwent the *stress test*. Before the impact of the adverse scenarios, the situation was as follows:

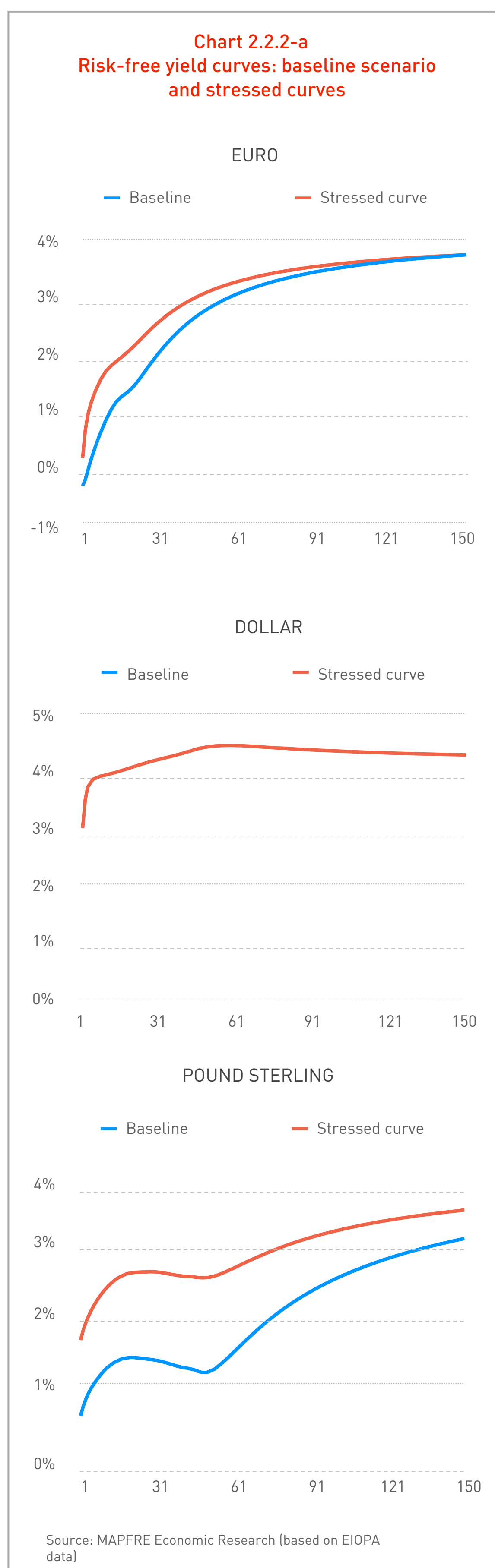
- Solvency ratio (sample aggregate): 202.4%
- Ratio of assets over liabilities: 109.5%
- Surplus of shareholders' equity over the required solvency capital: 331,6 billion euros

The situation at the aggregate level after the impacts resulting from the application of the scenario was as follows:

- Scenario 1 (YCU): loss of 196.2 billion euros of eligible shareholders' equity (solvency ratio after impact 145.2% / ratio of assets over liabilities 107.6%).
- Scenario 2 (YCD): loss of 153.8 billion euros of eligible shareholders' equity (solvency ratio after the impact 137.4%/ ratio of assets over liabilities 106.7%).
- Scenario 3 (NC): the aggregate loss is hardly significant (ratio of assets to liabilities after impact 109.3%).

Although the impact on the movement of the rate curves is significant in the two adverse scenarios, at the aggregate level there is sufficient shareholders' equity available to absorb them. However, six groups in the sample reported a solvency ratio of less than 100% in scenario 1 and seven in scenario 2. The intention of EIOPA is to address these vulnerabilities through the group supervision process in the associations of supervisors and give recommendations regarding the aspects it considers relevant.

Chart 2.2.2-a
Risk-free yield curves: baseline scenario and stressed curves



Source: MAPFRE Economic Research (based on EIOPA data)

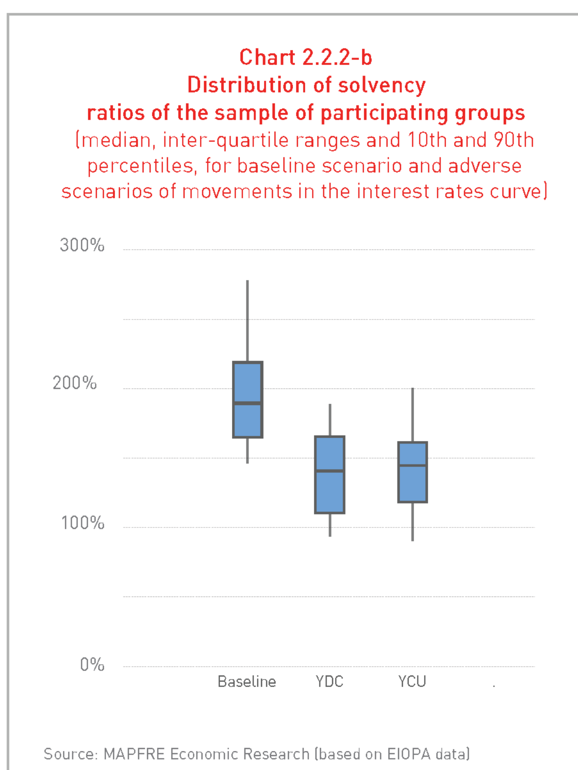
Figure 2.2.2-b, extracted from the EIOPA report, represents the distribution of the solvency ratios of the sample of participating groups with the median level, the inter-quartile ranges and the 10th and 90th percentiles, both in the baseline scenario and in the two adverse scenarios of movements in the rate curve.

If the effect of the transitional measures were to be omitted (the only measure of the Solvency II Directive that will end up disappearing), the situation after the impact of the adverse scenarios would be a solvency ratio that would fall to 130.9% in scenario 1 and 124.1% in scenario 2. Therefore, the condition of the sector would still be healthy, without prejudice to the greater or lesser impact it may have for certain insurance groups at an individual level.

Finally, if the effect of the transitional measures, the adjustment for volatility and the adjustment for marriage of the life insurance portfolios under financial immunization were omitted, the situation after the impact of the adverse scenarios would be:

- Scenario 1: loss of 325.1 billion euros of shareholders' equity (solvency ratio after impact 86.6%). 21 groups with SCR below 100%.

Chart 2.2.2-b
Distribution of solvency ratios of the sample of participating groups
(median, inter-quartile ranges and 10th and 90th percentiles, for baseline scenario and adverse scenarios of movements in the interest rates curve)



Source: MAPFRE Economic Research (based on EIOPA data)

- Scenario 2: loss of 280.6 billion euros of shareholders' equity (solvency ratio after impact 85.4%). 20 groups with SCR below 100%.

This last result highlights the importance of the measures introduced in the Solvency II Directive of long-term guarantees (adjustment for volatility and adjustment for marriage) and its anti-cyclical effect, which is positive for financial stability. The aforementioned measures are aimed at preserving the role played by insurance companies in the channeling of savings in the medium and long term, taking into account that their capacity to manage investments that support commitments with policyholders in the medium and long term makes them less vulnerable to occasional adverse movements in the markets, as long as they manage their risks appropriately. These measures will be reviewed in the planned reform of the Solvency II Directive in 2020.

Finally, it should be noted that EIOPA requested information regarding cyber risks faced by the European insurance groups participating in the *stress test* exercise. This information is being analyzed by EIOPA.

Solvency Reform II – 2018

In November 2018, the European Commission published the draft with the proposal to amend the Delegated Regulation (EU) 2015/35 of Solvency II[21]. This draft has been prepared on the bsasis technical advice comprising two parts issued by EIOPA, at the request of the European Commission itself, in a process that began in mid-2016. It still needs to be adopted by the Commission and sent to Parliament and the European Council for their consideration, so the procedure could be delayed by a few months before its publication in the Official Journal of the European Union.

The main reforms contemplated in the draft are summarized below:

- The capital charges of the standard formula for debt without credit rating and for the unlisted shares in which the insurers invest

are reduced under certain eligibility requirements. This reform is justified on the basis of the possible contribution of the European insurance industry to the objectives of the initiative known as the "Capital Markets Union" that seeks to achieve further development of capital markets in the European Union, as a means of financing for companies that is complementary to the traditional banking channel.

- A special regime is established for certain investments with limited long-term availability in shares, which will benefit from the same capital charges as strategic holdings, provided they meet certain requirements in terms of risk management of asset-liability and the investments themselves.

- To reinforce the proportionality of the Solvency II framework, modifications are made to the standard formula, including, among others, an exclusion from the mandatory application of the transparency approach to mutual funds and exceptions in the use of external credit ratings.

- The sub-module on catastrophe risks caused by man is simplified.

- Inconsistencies are eliminated with certain rules applicable to the banking sector, to the extent that their alignment is considered proportionate to the differences in the business model of both types of entities. They affect the classification of shareholders' equity, the treatment of risk in exposures to central counterparties and to exposures to regional administrations and local authorities. They also affect the treatment of derivatives, which is adjusted after the adoption of the market infrastructure regulation (EMIR).

- A series of additional principles are introduced to ensure a common playing field among Member States in the recognition of the ability to absorb losses from deferred taxes, which cannot be justified on the basis of different tax regimes. For this purpose, a series of additional principals are introduced that basically affect the supervision process to ensure a common playing field in the Union.

- Certain[23] parameters are updated based on additional data available since the last calibration, including the risks of non-life premiums, reserves and catastrophes and health risks.

- The treatment of the recognition of risk reduction techniques, the solvency calculation at group level and the volume measures of the premium and reserve risk to improve the risk sensitivity of the capital requirements under the standard formula is refined.

- Measures are introduced to improve transparency in technical information regarding the time structure of risk-free interest rates.

Insurance Europe has made its position on this proposal[22] public, expressing its appreciation for the efforts made on certain aspects of the reform, but regretting that it left out certain aspects that were important for the sector and that will continue to be debated for the planned revision of the Directive in 2020.

Evaluation of the structure of insurance intermediaries markets

In the month of December 2018, EIOPA published a report on the evaluation of the structure of insurance intermediaries markets in the European Economic Area (EEA), in accordance with the provisions of the Insurance Distribution Directive[23], which entered into force in October 2018.

This is the first of these reports that will be published on a regular basis and gives an idea of the state of insurance intermediaries markets with an analysis of data for the period 2013 to 2017. It is expected that in February 2020, EIOPA will prepare a report on the application of the Insurance Distribution Directive based on, among other elements, these periodic reports. The evaluation performed in this first report confirms that insurance intermediaries are characterized by a wide variety of distribution channels and

practices in terms of their registration and information provision requirements among the Member States.

In general, the information on insurance intermediaries that is available to the National Competent Authorities of each of the Member States is very heterogeneous, which in many cases prevents conclusions from being drawn throughout the EEA. In the case of intermediary categories, one factor that has contributed to the existence of these differences is that the legislation of the European Union, as well as the Insurance Mediation Directive, did not establish categories of legally defined insurance intermediaries. The "definition based on activity" gives Member States the flexibility to define these categories. In some cases, the information collected through the Solvency II reports offers a more accurate view of some of the aspects analyzed in the EIOPA study.

Despite the differences, some key developments have been detected in the European market:

- There are significant variations in the number of insurance intermediaries, and there is often a limited relationship with the total population and the size of the market. The number of registered intermediaries in the European markets analyzed amounted to 1,069,655.

- Although small, there is a decrease in the number of registered intermediaries, mainly due to stricter regulation and innovative alternatives in the distribution channels, along with other factors, such as the liquidation of certain insurance companies.

- In most markets, this decrease has mainly affected intermediaries registered as individuals and agents, which is also the largest category in Europe. Legal persons have a lower weight as intermediaries, but have grown in most of the Member States.

- There is diversity and lack of homogeneity among the categories of insurance intermediaries (56% of the total operates under categories that are specific to each Member State), which makes it difficult to draw conclusions at the European level.

- With the data offered by the 27 countries that break down information into that of brokers and agents, agents represent 32% of the total. In addition, the number of agents has fallen from 423,429 in 2013 to 338,426 in 2017 (-20%). On the other hand, brokers have increased by almost 8% in the same period, from 110,591 to 119,067, in the member countries that have provided this information.

- In the period analyzed, there has not been a significant change in the role played by the distribution channels. Bancassurance continues to be the largest channel in the Life insurance line, while agents form the majority in the Non-Life insurance sector.

- The report includes the number of notifications submitted by insurance intermediaries in the Member States to perform cross-border operations and compares the cross-border activities of insurance companies. In 2017, there were 13,861 intermediaries who had notified the competent authorities of their intention to engage in cross-border business. Of these, more than 90% (13,047) reported their intention to do business under the Freedom of Service (FoS) modality, while only 413 notified their intention to operate under the Freedom of Establishment (FoE) regime. A significant part of the notifications from intermediaries refers mainly to neighboring Member States: around 20% of the notifications received in 2017 (from the Member States where this information is available).

- With regard to remuneration, there are two models that prevail in the sale of insurance products by insurance intermediaries in the EEA: one based on commissions and the other on fees. In some cases, remuneration can be mixed, for example, being composed

of insurance company commissions to the insurance intermediary for insurance distribution activity and a commission from the client for the management of the contract after its conclusion. In most Member States, insurance agents seem to be paid almost exclusively with commissions, while brokers are often paid with commissions, fees or a combination of both.

- Commissions have remained stable between 2016 and 2017, with a significant difference between the different lines of business and between Member States. "Other life insurance" is the life insurance business line with the highest commissions. For some Non-Life insurance lines, the commissions of companies are around (and even above) 20%.

- Finally, the report analyzes the growth of "Other emerging insurance distribution channels" and InsurTech. Existing data on price comparators and aggregators are limited, which makes accurate analysis difficult. However, it is estimated that in 2016 there were 214 major websites and online brokers in Europe present throughout the continent.

- The lack of unambiguous regulation of websites comparing insurance products under the previous Insurance Mediation Directive and the risk that it may harm consumers has led to much stricter regulation and supervision at national level. The Insurance Distribution Directive provides clearer regulation of these comparators, including them in the definition of "insurance distribution".

- The report mentions the digitalization of "financial advice" in what it refers to as "robot advice", which consists of providing advice without human intervention or with limited human intervention. In general, it seems that this phenomenon is growing, though not very quickly, and the scale of the market is still quite limited.

- The direct channel and so-called online insurance markets play an increasing role in the sale of insurance products.

The report is accompanied by an annex with a country analysis of the main insurance distribution markets[24]. Here are some interesting facts:

- Italy represented 12% of the population of the European Union in 2016, 11% of direct insurance premiums and 23% of intermediaries. In 2017, it had 23,704 legal entities and 204,972 individuals in a clear downward trend since 2013; since then, legal entities have decreased by -1.5% and intermediaries as individuals have decreased by -6.5%. Before the entry into force of the Directive of October 1, 2018, there were 5 categories of intermediaries in the Italian registry: agents (the most important category in Non-Life insurance and whose remuneration comes from commissions, bonuses and rappels), brokers, bancassurance (the most important category in life insurance), direct collaborators and other intermediaries. The number of notifications by intermediaries to operate in the foreign market has gradually decreased.

- Spain represented 9% of the population of the European Union in 2016, 5% of direct insurance premiums and 8% of intermediaries. In 2017, it had 14,548 legal persons and 64,824 natural persons in a clear downward trend since 2013 in natural persons and stable in the number of legal persons. The number of notifications of intermediaries to operate in the foreign market grew significantly in 2017, both for the establishment of and for the freedom to provide services.

- Germany represented 16% of the population of the European Union, 17% of direct insurance premiums and 22% of intermediaries. The responsibility for supervision is divided among the Chamber of Commerce (IHK in German), which registers the intermediaries, and the Financial Services Supervisory Authority (NCA), which controls agents.

The analysis of intermediaries for the 2013-2017 period shows a drop in agents tied to insurers (-18%) and in the number of requests for agent licenses (-7%), with the percentage of brokers and auxiliary agents being stable. The number of intermediaries has historically been very high and the personal relationship is that which has traditionally dominated the European distribution channel.

Packaged Retail Investment and Insurance Products (PRIIP) and Key Information Document (KID)

On October 1, 2018, the European Supervisory Authorities (ESA) expressed in a letter to the European Commission their intention to issue proposals to support legislative changes to hinder the possibility of duplicating information requirements to be received by clients acquiring mutual funds after January 1, 2020, and address key issues that have arisen since the implementation of the investor key information document (KID). On November 8, the three authorities issued a joint public consultation[25] whose central purpose concerns possible changes that would be necessary in relation to profitability scenarios.

To provide background of the reasons behind this consultation it is worth mentioning that the PRIIPs[26] Regulation establishes the obligation of producers of packaged investment products aimed at retailers and insurance-based investment products (PRIIPs) to prepare the investor key information document (KID) with standardized information and deliver it to potential clients well in advance of their acquisition. It also establishes that ESAs will develop Regulatory Technical Standards on the content and presentation of KIDs, as well as the delivery time thereof.

The Regulatory Technical Standards were adopted by each of the ESA Board of Supervisors in April 2016 and subsequently approved by the European Commission in June 2016 in the form of a Delegated Regulation. In September 2016, during the scrutiny period, the European Parliament objected to the regulations proposed and called for changes in a series of specific areas. This objection delayed the application of the KID regime for one year until January 1, 2018.

For its part, the PRIIP Regulation establishes a temporary exemption (until December 31, 2019) from the obligation to prepare and deliver the KID of PRIIPs to undertakings for the collective investment in transferable securities (UCITS) or other mutual funds that publish a document of equivalent key data (KII of UCITS). The European Commission adopted a revised Delegated Regulation in March 2017 with amendments to address the concerns expressed by the European Parliament. This allowed the final rules to be published on April 12, 2017 as Delegated Regulation (EU) 2017/653 of the European Commission.

In July 2017, the European Commission published a communication containing guidelines on the application of the PRIIP Regulations. The aim of the communication was to facilitate the implementation and compliance with the rules by smoothing out possible interpretive divergences across the European Union. In order to clarify the application of the rules and promote common supervisory approaches and practices in the implementation and supervision of the KID, the ESAs publish "Questions and Answers (Q&A)" that have no binding force nor are they subject to a procedure of "comply or explain." Due to their nature, there is no formal inquiry regarding questions and answers in the case of material intended to be edited and updated continuously, as new questions are received.

To make the necessary amendments within a time period that guarantees its application from January 1, 2020, the scope of the proposals in the consultation is limited and the period for which it has been open to the public was reduced. The deadline for submitting comments was reached on December 6, 2018. However, discussions continue between co-legislators regarding the date of application of the PRIIPS Regulation to the mutual funds and the deadline to undertake a complete revision of this regulation. The decision on the final

recommendations that the ESAs will make to the European Commission will take into account both the answers to the consultation and progress made in the political discussions. Furthermore, the outcome of this review is without prejudice to a broader review that could be performed at the beginning of the next mandate of the European Parliament.

The proposed changes are presented in section 4 of the document submitted by the ESAs to the Commission, which, in turn, is divided into four main sections: (i) proposals to change the approach regarding the presentation of profitability scenarios in the KID of PRIIPs (section 4.1); (ii) potential changes to a limited number of other issues of a practical or technical nature detected since the implementation of the PRIIPS Regulation and based on the information collected by the ESAs (section 4.2), and (iii) other possible changes to the Delegated Regulation 2017/653 in case the temporary exemption of the KID of PRIIPs for UCITS and other mutual funds is terminated (section 4.3). In addition, section 5 of the document includes an analysis of the costs and benefits of the proposed changes, and sections 6 and 7 contain annexes relating to sections 4.1 and 4.3, respectively.

Spain Law on the distribution of private insurance and reinsurance

In Spain, the Bill on the distribution of private insurance and reinsurance is in the final phase of parliamentary procedure, once the deadline for submitting amendments has expired. On October 2, 2018, the 100 amendments submitted by the different Parliamentary Groups were published in the Official Gazette of the Parliament, and the next step is for the Economy and Business Commission of the Spanish Parliament to approve the amendments and issue the corresponding report, before moving on to the Senate.

Tables: macroeconomic forecast scenarios

Table A.1
Baseline and risk scenarios: gross domestic product (GDP)
(annual growth, %)

	Baseline					
	2015	2016	2017	2018	2019	2020
United States	2.9	1.6	2.2	2.9	2.5	1.9
Eurozone	2.0	1.9	2.5	1.9	1.7	1.6
Germany	1.5	2.2	2.5	1.6	1.7	1.6
France	1.0	1.0	1.1	2.3	1.6	1.6
Italy	0.8	1.3	1.6	0.9	0.4	0.8
Spain	3.6	3.2	3.0	2.6	2.3	2.1
United Kingdom	2.4	1.8	1.7	1.2	1.2	2.2
Japan	1.3	0.6	1.9	0.8	1.0	0.4
Emerging markets	4.7	4.3	4.4	4.7	4.5	4.5
Latin America[1]	1.3	0.3	-0.6	1.3	2.2	2.5
Mexico	3.3	2.7	2.3	2.0	2.0	2.0
Brazil	-3.6	-3.3	1.1	1.2	2.3	2.6
Argentina	2.7	-1.7	2.8	-2.5	-1.3	3.8
Emerging European[2]	3.9	4.7	3.3	6.0	1.9	2.8
Turkey	6.0	3.3	7.4	3.2	-1.7	4.0
Asia Pacific[3]	5.9	6.2	6.2	6.0	5.8	5.6
China	6.9	6.7	6.9	6.6	6.2	5.8
Indonesia	4.9	5.0	5.1	5.1	5.2	5.3
Philippines	6.0	6.9	6.7	6.3	6.2	5.8
World	3.6	3.5	3.7	3.6	3.3	3.2

	Risk scenario					
	2015	2016	2017	2018	2019	2020
United States	2.9	1.6	2.2	2.9	1.6	0.9
Eurozone	2.0	1.9	2.5	1.9	0.7	0.8
Germany	1.5	2.2	2.5	1.6	0.9	0.7
France	1.0	1.0	1.1	2.3	1.6	1.0
Italy	0.8	1.3	1.6	0.9	-0.8	-0.1
Spain	3.6	3.2	3.0	2.6	1.2	1.5
United Kingdom	2.4	1.8	1.7	1.2	0.8	0.6
Japan	1.3	0.6	1.9	0.8	0.3	-0.8
Emerging markets	4.7	4.3	4.4	4.7	3.1	2.1
Latin America[1]	1.3	0.3	-0.6	1.3	1.4	1.6
Mexico	3.3	2.7	2.3	2.0	0.4	1.8
Brazil	-3.6	-3.3	1.1	1.2	1.9	2.2
Argentina	2.7	-1.7	2.8	-2.5	-1.5	3.1
Emerging European[2]	3.9	4.7	3.3	6.0	1.9	1.0
Turkey	6.0	3.3	7.4	3.2	-2.0	3.8
Asia Pacific[3]	5.9	6.2	6.2	6.0	5.5	4.6
China	6.9	6.7	6.9	6.6	5.7	5.6
Indonesia	4.9	5.0	5.1	5.1	3.9	5.9
Philippines	6.0	6.9	6.7	6.3	6.3	6.4
World	3.6	3.5	3.7	3.6	2.2	1.5

Source: MAPFRE Economic Research (with information from national statistics centers and the IMF)

[1]Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela; [2]Russia, Turkey, Commonwealth of Independent States (CIS) and Central Europe; [3]Association of Southeast Asian Nations (ASEAN)
Forecast end date: January 8, 2019

Table A.2
Baseline and risk scenarios: inflation
(end of period, %)

	Baseline					
	2015	2016	2017	2018	2019	2020
United States	0.4	1.8	2.1	1.9	2.2	1.9
Eurozone	0.2	0.7	1.4	1.8	1.4	1.7
Germany	0.3	1.7	1.7	2.1	1.5	1.8
France	0.1	0.3	0.8	1.3	2.2	1.5
Italy	0.2	0.1	0.9	1.6	1.2	1.6
Spain	-0.3	1.0	1.4	1.6	1.3	1.6
United Kingdom	0.1	1.2	3.0	2.2	1.2	2.0
Japan	0.2	0.3	0.6	0.9	2.1	1.1
Emerging markets	4.7	4.6	4.2	4.5	4.7	4.5
Latin America[1]	5.0	6.2	4.6	6.0	4.9	4.2
Mexico	2.3	3.2	6.6	4.8	4.0	3.5
Brazil	10.4	7.0	2.8	4.1	4.1	4.0
Argentina	26.0	39.3	23.3	47.5	26.6	19.5
Emerging European[2]	3.4	3.9	4.2	6.8	8.5	7.7
Turkey	8.2	7.6	12.3	22.8	15.3	11.1
Asia Pacific[3]	2.2	2.5	2.8	4.0	3.0	3.2
China	1.5	2.2	1.8	2.4	2.1	2.6
Indonesia	4.8	3.3	3.5	3.7	3.7	3.5
Philippines	0.3	2.0	3.0	6.0	3.4	4.0
World	2.9	2.9	3.0	3.3	3.6	3.5

	Risk scenario					
	2015	2016	2017	2018	2019	2020
United States	0.4	1.8	2.1	1.9	0.7	1.3
Eurozone	0.2	0.7	1.4	1.8	-0.9	0.1
Germany	0.3	1.7	1.7	2.1	-0.5	0.6
France	0.1	0.3	0.8	1.3	1.3	1.3
Italy	0.2	0.1	0.9	1.6	-0.7	-0.0
Spain	-0.3	1.0	1.4	1.6	-2.0	-0.2
United Kingdom	0.1	1.2	3.0	2.2	0.0	1.1
Japan	0.2	0.3	0.6	0.9	0.6	-0.2
Emerging markets	4.7	4.6	4.2	4.5	5.8	5.5
Latin America[1]	5.0	6.2	4.6	6.0	5.6	4.6
Mexico	2.3	3.2	6.6	4.8	3.3	3.5
Brazil	10.4	7.0	2.8	4.1	4.5	4.6
Argentina	26.0	39.3	23.3	47.5	23.7	20.7
Emerging European[2]	3.4	3.9	4.2	6.8	7.8	6.9
Turkey	8.2	7.6	12.3	22.8	13.5	11.8
Asia Pacific[3]	2.2	2.5	2.8	4.0	3.8	4.0
China	1.5	2.2	1.8	2.4	-0.4	1.6
Indonesia	4.8	3.3	3.5	3.7	3.0	3.1
Philippines	0.3	2.0	3.0	6.0	0.4	5.1
World	2.9	2.9	3.0	3.3	3.3	2.9

Source: MAPFRE Economic Research (with information from national statistics centers and the IMF)

[1]Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela; [2]Russia, Turkey, Commonwealth of Independent States (CIS) and Central Europe; [3]Association of Southeast Asian Nations (ASEAN)
Forecast end date: January 8, 2019

Table A.3
Baseline and risk scenarios: 10-year government bond yield
(end of period, %)

	Baseline					
	2015	2016	2017	2018	2019	2020
United States	2.27	2.45	2.40	3.15	3.16	3.49
Eurozone	1.20	1.04	0.91	1.19	1.68	2.32

	Risk scenario					
	2015	2016	2017	2018	2019	2020
United States	2.27	2.45	2.40	3.15	1.83	0.98
Eurozone	1.20	1.04	0.91	1.19	1.05	1.22

Source: MAPFRE Economic Research (with information from national statistics centers and the IMF)
Forecast end date: January 8, 2019

Table A.4
Baseline and risk scenarios: exchange rates
(end of period, %)

	Baseline					
	2015	2016	2017	2018	2019	2020
USD-EUR	0.92	0.95	0.83	0.88	0.85	0.83
EUR-USD	1.09	1.05	1.20	1.14	1.18	1.20
GBP-USD	1.48	1.23	1.35	1.35	1.41	1.45
USD-JPY	120.27	116.78	112.69	112.51	109.61	109.79
USD-CNY	6.49	6.94	6.51	6.91	6.71	6.46

	Risk scenario					
	2015	2016	2017	2018	2019	2020
USD-EUR	0.92	0.95	0.83	0.88	0.82	0.78
EUR-USD	1.09	1.05	1.20	1.14	1.22	1.28
GBP-USD	1.48	1.23	1.35	1.35	1.41	1.49
USD-JPY	120.27	116.78	112.69	112.51	107.04	106.82
USD-CNY	6.49	6.94	6.51	6.91	7.36	7.61

Source: MAPFRE Economic Research (with information from national statistics centers and the IMF)
Forecast end date: January 8, 2019

Table A.5
Baseline and risk scenarios: benchmark interest rate
(end of period, %)

	Baseline					
	2015	2016	2017	2018	2019	2020
United States	0.50	0.75	1.50	2.50	3.00	3.00
Eurozone	0.00	0.00	0.00	0.00	0.00	0.25
China	2.32	2.59	3.09	3.04	3.34	3.78

	Risk scenario					
	2015	2016	2017	2018	2019	2020
United States	0.50	0.75	1.50	2.50	3.50	3.75
Eurozone	0.00	0.00	0.00	0.00	0.25	0.50
China	2.32	2.59	3.09	3.04	0.54	2.61

Source: MAPFRE Economic Research (with information from national statistics centers and the IMF)
Forecast end date: January 8, 2019

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References

1/ The effects of the Trump administration's tax reform will begin to fade from 2020 onward until they are totally diluted (except in the unlikely event of a renewal) by 2023.

2/ Last December, the United States suffered the 10th partial shutdown of the public administration due to a breach of the statutory debt ceiling of 100% of GDP.

3/ At the G20 summit last November, presidents Trump and Xi Jinping met. At that meeting, they agreed a 90-day halt to the tariff escalation, meaning that the 10% tariffs on products imported from China will not now be increased to 25% in January as had been planned. This truce is intended to allow both governments to look into ways of finding a more balanced and fair trade relationship between them.

4/ Mainly: State, non-financial corporate and household.

5/ See: MAPFRE Economic Research, *Economic and Industry Outlook 2018: Fourth Quarter Perspectives,* Madrid, Fundación MAPFRE, October 2018, pp. 15-18 ("Vulnerabilidad de mercados emergentes: índice de riesgo emergente" [Vulnerability of emerging markets: emerging risk index]).

6/ BRICS (Brazil, Russia, India, China, South Africa), Mexico, Indonesia, Argentina and Turkey.

7/ Given the needs of Italy and France (not yet official in the latter case) to increase the public deficit against a background of political change at European Commission, Council and Parliament level, a regional decision could be reached on the short-term fiscal objectives, especially in the current cyclical situation in which the impulse appears to be running out of steam. In this regard, Italy's fiscal situation is not resolved. The European Commission would appear to be considering an excessive deficit procedure based not only on the deficit but also on the level of debt, which would result in more lasting sanctions. With the conclusion of the ECB's asset purchase program in December, and Italy's risk premium at 300 bps, the focus will be on the effort to service that country's debt, which stands at 130% of GDP. Italy is one of the largest economies of the eurozone, and has considerable negotiating power with the Commission. However, the Commission cannot make fiscal concessions to a single country, and for this reason it can be expected that it will set out the framework of a fiscal loosening in a program that affects the entire zone.

8/ We expect the price of oil to converge moderately around USD 65/b between 2019 and 2020.

9/ At its December meeting, the Organization of the Petroleum Exporting Countries (OPEC) decided to reduce production by 1.2 million barrels a day (0.8 million barrels a day by the members and 0.4 million barrels a day by the non-members), which was in line with the consensus of expectation. No exact goals were set for each country, but the commitment is that the OPEC countries will lower the October levels by 2.5% and the non-OPEC countries by 2.0%. Iran, Venezuela and Libya were exempted from the commitment due to the special situations in which they find themselves.

10/ The neutral/natural interest rate of the economy (R*) is the rate at which neither economic activity and inflation are stimulated or slowed.

11/ This idea is linked to the fact that the US economy is showing growth with full employment and low inflation, assumed to be generated by greater growth potential than was previously thought. Proponents of this idea point to the fact that there has recently been an increase in total-factor productivity (digitalization, increase in labor productivity, among others), as well as an increase in the *stock* of capital that was not being taken into account. Both of these factors more than compensate for the loss of the contribution of the employment factor, which in any event is reviving in the light of the recovery of the current employment rates.

12/ This view is also consistent with the hypothesis of secular stagnation, further strengthened by demographic factors that will not be diluted until the next population cohort (in the middle of the next decade).

13/ The economies of the eurozone and Japan have avoided the generation of imbalances by maintaining a mix of monetary and fiscal policy in the neutral or anti-cyclical territory between initial fiscal austerity and recurring monetary laxity (anti-cyclical economic policy), thus preventing the accumulation of nominal imbalances as in the case of the US economy.

14/ The emerging markets accumulated imbalances during the QE implemented by the US Federal Reserve because the rapidly growing liquidity surplus resulted in lending and inflation of assets (especially residential).

15/ See: MAPFRE Economic Research, *Economic and Industry Outlook 2018: Fourth Quarter Perspectives*, op.cit., pp. 15-18 et seq.

16/ Beyond the economic effect, this new protectionism will also have effects on current accounts and on inflation, a situation from which some countries would clearly benefit (for example the United States, by reducing debt and the trade deficit). See: MAPFRE Economic Research, *Economic and Industry Outlook 2018: Third Quarter Perspectives*, Madrid, Fundación MAPFRE, July 2018.

17/ The surplus in China's current account balance in the third quarter was at its lowest in 20 years. The fact that exports hold up well until October is explained, above all, by the advance effect of exports to the United States before the entry into force of the new tariff rates (now suspended for 3 months), and the devaluation of the Yuan from 6.3 to almost 7.0 CNY/USD in recent months.

18/ Such as the *targeted medium-term lending facility* that lends for 3 years at 3.5% below the market, or the public underwriting of loan collateral given to large companies.

19/ https://www.iaisweb.org/page/consultations/current-consultations/ics-version-20

20/ https://eiopa.europa.eu/Publications/Surveys/insurance_groups_stress_test_2018.pdf

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25/ https://eiopa.europa.eu/Publications/Consultations/
Joint%20Consultation%20Paper%20on%20targeted%20amendments.pdf

26/ Regulation (EU) No 1286/2014 of the European Parliament and of the Council of November 26, 2014 on key information documents related to retail investment products and insurance-based investment products (relevant text for the purpose of the European Economic Area).

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